McGRAW-HILL ACCOUNTING SERIES

F. H. ELWELL, CONSULTING EDITOR

C.P.A. PROBLEMS

AND QUESTIONS IN THEORY AND AUDITING

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C.P.A. PROBLEMS

AND QUESTIONS IN THEORY AND AUDITING

BY

JACOB B. TAYLOR, M.A., C.P.A.

Professor of Accounting and Chairman of the Department of Accounting, Ohio State University; Certified Public Accountant (North Dakota and Ohio); Member of the American Institute of Accountants

AND

HERMANN C. MILLER, M.A., C.P.A.

Professor of Accounting, Ohio State University; Certified Public Accountant (Ohio and Wisconsin); Member of the American Institute of Accountants

Authors of "Intermediate Accounting"

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PREFACE

The second edition of "C.P.A. Problems and Questions in Theory and Auditing" has been prepared, as was the first edition, "to fill the needs of candidates for the C.P.A. certificate and to meet the requirements of advanced accounting students."

The problems selected for this edition have been taken from the examinations given in the various states since the publication of the earlier edition. Adhering to the objectives of the first edition, the authors have selected problems solely for their value in furnishing the conscientious student a thoroughgoing review of accounting principles and a comprehensive study of modern accounting practice.

The outline follows closely that of the earlier edition because of a belief in the natural and logical pattern. To some extent it will be found that new sections have been possible, owing to the increasing emphasis upon such subjects as governmental accounting, contractors' accounts and budgeting. However, no attempt has been made to incorporate problems based solely upon the income tax provisions of various federal Revenue Acts.

Questions on accounting theory and auditing are presented because it is believed that these may be studied to advantage in connection with the solution of the various problems.

The Appendix contains four complete and representative C.P.A. Examinations (American Institute of Accountants, May and November, 1938, and Ohio, May and November, 1938). These may be used by the student to check upon his progress and to observe the usual time limits imposed in the examination.

An effort has been made to give full credit for all material used. Permission to copy has been granted by the various examining bodies. No attempt was made to edit the problems, but they have been presented exactly as given by the examining boards. The authors wish to express their indebtedness to these state boards and to the American Institute of Accountants for their cooperation, which made this volume possible.

OHIO STATE UNIVERSITY,
January, 1939.

JACOB B. TAYLOR,
HERMANN C. MILLER.

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PART I

FINANCIAL AND OPERATING STATEMENTS—THEIR PREPARATION, REVISION AND ANALYSIS

SECTION I

PREPARATION, REVISION AND CORRECTION OF STATEMENTS

Problem 1

(American Institute of Accountants, November, 1933)

The following is a statement of the profit and loss of the Lacdun Company for the year ended August 31, 1933:

Sales		$600,000
Cost of sales:		
Materials	$195,000	
Direct labor	130,000	
Factory expense	65,000	390,000
Gross profit		$210,000
Selling expenses		$ 90,000
Administrative and general expenses		40,000
Total		$130,000
Net profit		$ 80,000

For the year ending August 31, 1934, it is expected that the sales will increase 33⅓% in volume, while selling and general expense, as well as the production costs, are estimated to advance as follows:

> The cost of materials and direct wages are expected to go up 20%, but there will be a reduction of 10% in the material content of the finished product.
>
> Factory expense is expected to be relatively 15% higher.
>
> Selling expense is expected to increase 20% and general expense 25%.

By what percentage must the selling price be increased in order that the net profit for the year ending August 31, 1934, shall exceed that of the previous year by 25%?

Problem 2

(American Institute of Accountants, May, 1936)

The operations of K. Inc. for the fiscal year ended June 30, 1935, are expressed in the following table of percentages:

		Per cent.
Sales		100 00
Cost of sales		66 67
Gross profit		33.33
Expenses:		
Selling and delivery	10.00	
Administration and general	7.50	17 50
Net profit		15.83

There was no inventory at the beginning of the fiscal year and during that year the company, operating at full capacity, produced 10,000 units, of which 8,000 were sold. The materials, labor and overhead were, respectively, 35%, 45% and 20% of the cost of production.

The current year's costs are expected to show increases as follows: materials, 15%; labor, 10%; overhead, 20%. On the other hand, it is expected that, because of more efficient methods, the production will be increased 10%, and you are to assume that this is accomplished without additional increases in the cost of production.

Negotiations are pending with S & R who are prepared to purchase K. Inc.'s entire output for the current year, together with the stock on hand at the beginning of the current year, if the parties can agree on a price. In that event the amount of the selling and delivery expense would be reduced 75%, and there would be no change in the amount of the administration and general expense.

Accepting the indicated changes in costs and production, what percentage of increase or decrease in the 1935 selling price per unit would enable K. Inc. to realize, under the contemplated arrangement, a net profit of 20% on the sales?

Problem 3

(American Institute of Accountants, May, 1936)

A corporation owning a deposit of glass sand has a capital stock of $500,000 and a surplus of $67,500. Its fixed charges, interest,

management expense, etc., amount to $43,000 a year. This amount is constant and not affected by the output.

The accounts show that it costs $3.60 a ton to operate the deposit. This amount includes depletion and all costs except the fixed charges mentioned above, but it does not include state and federal income taxes. The selling price is $6 a ton.

State taxes amount to 4½% of the income; the federal income tax is 13¾% and is not allowed as a deduction in computing the state tax.

How many tons a year must be sold in order that the corporation may make 7% on its investment (capital stock plus surplus)?

How many tons must be sold if the return is to be 8%?

In each case the return is to be computed after payment of the income taxes. Fractional parts of tons should be ignored.

Problem 4

(New York, November, 1932)

The balance-sheet of the Kokomo Manufacturing Company, September 30, 1932, contains the following:

Accrued payroll	$17,514 92

Investigation shows that this balance is the result of:

Payroll account

Particulars	Debits	Credits
Bank balance, October 1, 1931	$ 4,000.00	
Accrued payroll, October 1, 1931		$ 9,617.43
Credits to current bank account	485,946.03	
Debits to expense accounts		480,219.36
Salesmen's advances		11,402 93
Accrued payroll, September 30, 1932		6,221.23
Balance, September 30, 1932	17,514.92	
Totals	$507,460.95	$507,460.95

Analysis of the preceding figures produces:

1. Credits to current bank account:

Payroll advances	$480,219.36	
Salesmen's advances	11,402.93	$491,622.29
Deductions for compensation insurance		5,676.26
Total		$485,946.03

2. The payrolls charged to expense, and salesmen's advances, include the accrual of October 1, 1932.

3. Accrued payrolls are composed of the following:

	September 30 1931	September 30 1932
Accrued wages	$8,817.43	$ 5,721.23
Accrued current advances to salesmen	800.00	500 00
Totals	$9,617.43	$ 6,221 23

4. Analysis of advances to salesmen produces:

Balance, October 1, 1931 (accrual of $800 included)	$ 1,301 48
Cash advances during year	11,402 93
Accrual, September 30, 1932	500 00
Total	$13,204 41
Commissions earned	11,782.19
Balance, September 30, 1932	$ 1,422 22

5. The individual workers' payroll checks, properly authorized, payable from payroll bank account during the year ended September 30, 1932, totaled $495,546.15.

Required:

1. Determine proper balances for the accounts affected.
2. Set up journal entry to adjust.

Problem 5

(Wisconsin, November, 1932)

You are engaged in auditing the records of the X Company for the calendar year 1931. Cash accounts appearing in the general ledger December 31, 1931, are as follows:

Cash	$22,256.61
Petty cash and change fund	200.00

Among the items appearing in the cashier-bookkeeper's cash reconciliation as of December 31, 1931, are the following:

Checks outstanding, December 31, 1931	$ 6,483.22
Cash balance per ledger, December 31, 1931	22,256 61
Bank balance, December 31, 1931	26,311 15
Check charged by bank in error corrected by bank, January 5, 1932	125.00
Deposit of December 31, 1931, credited by bank on January 2, 1932	540 71

The total cash receipts from January 1, 1932, to January 18, 1932, inclusive, the date of your cash account, appear in the cash book as $10,219.62. The total deposits credited on the bank statements from January 1, 1932, to January 18, 1932, is $7,814.67. The count of cash on hand including the petty cash fund at the close of business on January 18, 1932, was as follows:

Currency	$ 656.00
Coins	59.37
Cashier-bookkeeper's I.O.U's., dated January, 1932	38.00
Other employees' I.O.U's., dated January, 1932	17.00
Paid expense bills	26 25
Customers' checks in payment of accounts	446.63
Total	$1,243.25

Further investigation reveals the following:

1. That fictitious credit memoranda were issued on August 18, 1931, and December 31, 1930, in the amount of $500 and $346, respectively, crediting a customer's account and charging inventories, thereby adjusting the customers' account for cash remittances improperly recorded.
2. That other customers' remittances totaling $892.47 received during the calendar year 1931 were not recorded.
3. That checks, aggregating $648.69, received from customers on account during the period January 1, 1932, to January 18, 1932, were included in the bank deposits of that period but were not recorded in the cash receipts.
4. That unrecorded receipts issued to customers in cashier's drawer for remittances on hand undeposited on January 18, 1932, totaled $943.24.
5. That a check in the amount of $245, carried as outstanding, originally issued on September 2, 1931, to a trade creditor because of the deduction of a cash discount of $5 not allowable, has been returned and was replaced by a check for $250 drawn on September 28, 1931. No entry was made on books to record cancellation of original check.
6. That a check for $147 issued on December 22, 1931, to a trade creditor was returned because of the deduction of a $3 discount not allowed and was deposited in the bank

account on December 30, 1931. No record of this transaction was made on the books.

7. That a credit by the bank for $28 on October 15, 1931, for refund of interest on prepayment of a discounted bank loan was not recorded.

Required: (1) To make the necessary journal entries to adjust the books, to show the correct cash balance for report purposes as of December 31, 1931, and the reconciliation of that balance with the bank; (2) the balance as of December 31, 1931, in any adjustment account you may set up; and (3) the total cash shortage if any.

Problem 6

(American Institute of Accountants, May, 1934)

On the basis of the following profit-and-loss account of the Excelsior Company and summaries of agreements with Jones and Smith, employees, compute the commissions payable to the latter for the year 1933.

EXCELSIOR COMPANY

Profit-and-loss account for the year ended December 31, 1933

Gross profit before depreciation		$150,000
Depreciation		30,000
Gross profit		$120,000
Selling and administrative expenses (including $2,000 for state taxes)		94,000
		$ 26,000
Other income, interest, etc	$25,000	
Less: Interest on mortgage	20,000	5,000
		$ 31,000
Capital stock tax		1,000
Net profit before special commissions and federal income tax		$ 30,000

Agreement with Jones:

Special commission to be equal to 15% of the net profit transferred to surplus.

Agreement with Smith:

Special commission to be equal to 15% of the net profit before charging federal and state taxes, interest on mortgage and the

commission payable to Smith under this agreement, but after charging, for the purpose of computing this commission only, additional depreciation of $20,000.

Complete the profit-and-loss account and show separately the charges for commission and federal income tax, using 14½% as the rate of income tax.

Problem 7

(American Institute of Accountants, November, 1935)

The Clark Manufacturing Company is being operated by a committee of its creditors and you are called in to prepare financial statements for information of the creditors. Your examination reveals the following:

1. After the creditors' committee had taken charge, but before the date of your examination, a fire had occurred causing an estimated damage of $80,000, made up as follows:

Machinery and equipment	$50,000
· (Book value less depreciation)	
Inventories	20,000
Customers' merchandise on hand for work to be done thereon	10,000
Total	$80,000

(The building occupied was leased and not owned.)

The company had accepted from the insurance companies $57,080 in full settlement for the loss, and this amount was still on deposit at the date of your examination. The cost of clearing the debris and obtaining the equipment considered necessary would be $47,250.

2. There is $130,112 in accounts and notes payable to creditors, parties to an agreement whereby each creditor accepted a note of the corporation, due October 31, 1937, and bearing interest at 5% per annum. The notes are secured by mortgage on all plant property and by all the issued capital stock. The latter is held in escrow. There will be $13,348 interest accrued on the notes at maturity.
3. Expenses have accrued to the amount of $1,532.
4. There is due to the president $30,000 for salary and cash advances for which the corporation gave him a demand

note. A part of the agreement with the creditors was a covenant by the president to take capital stock for this note at par. The president could not surrender the note, however, because he had used it as collateral to secure a personal loan. The stock had therefore not yet been issued.

5. There is a corporation note dated February 1, 1931, payable on demand to the widow of the former treasurer, for $6,900. She has agreed to subrogate her claims to those of the other creditors.
6. The liabilities incurred since the creditors entered into the agreement aggregate $15,699.
7. There are $17,400 notes payable for equipment purchased prior to the creditors' agreement, due in monthly instalments of $2,175 each and secured by chattel mortgage on the equipment.
8. Balances [illegible] $3,066 are due employees under an arrangement whereby they received 90% of their earnings in cash and 10% in scrip payable October 31, 1937.
9. A deficit of $178,032 existed at the date of the creditors' agreement. The subsequent loss from operations is $8,942 before adjustment of the fire loss.
10. The authorized capital stock is 150,000 shares of $10 each, of which 50,000 shares are issued and outstanding and placed in escrow for the benefit of creditors. Of the unissued 100,000 shares 5,350 were subscribed in 1928 but the subscriptions were never paid. They are of doubtful status and are given to the creditors' attorney for collection.

From the foregoing data prepare the liabilities side of the balance-sheet as you would submit it to your client, together with footnotes to the balance-sheet which in your opinion are necessary for a clear understanding of the corporation's financial position.

Problem 8

(New York, October, 1937)

Submit statements for the following situation which you, as a competent accountant and auditor, would prepare:

THE SCARBOND MANUFACTURING COMPANY
Trial balance, December 31, 1936

Cash	$ 2,850,000	$ 2,300,000
Notes receivable	50,000	
Accounts receivable	1,300,000	1,050,000
Raw materials	500,000	375,000
Direct labor	400,000	400,000
Superintendent's salary	12,000	
Indirect labor	35,000	
Factory office salaries	15,000	
Cost office salaries	10,000	
Repairs to plant and machinery	30,000	
Power	5,000	
Depreciation of plant and machinery	33,000	
Factory expense and supplies	10,000	
Manufacturing expenses applied		400,000
Work in process	1,175,000	1,100,000
Finished goods	1,100,000	900,000
Plant and machinery	1,100,000	
Reserve for depreciation of plant and machinery		33,000
Notes payable		50,000
Accounts payable	1,200,000	1,267,000
Capital stock		1,800,000
Sales		1,300,000
Cost of sales	900,000	
Sales salaries	56,000	
Sales expenses	42,000	
Advertising	33,000	
Freight out	12,000	
Shipping expenses	16,000	
Officers' salaries	35,000	
Office salaries	13,000	
Office expense	13,000	
Sales discount	15,000	
Interest expense	2,500	
Bad debts	12,500	
Totals	$10,975,000	$10,975,000

This company began business as of January 1, 1936. Its entire capital is paid up.

The work in process December 31, 1936, has been analyzed as to charges, as follows:

Material	$18,750
Labor	28,125
Overhead	28,125
Total	$75,000

During the year, 100,000 units of product were completed and delivered to the warehouse. Of this number, 65,000 units were sold.

Problem 9

(New York, October, 1937)

Prepare a balance-sheet and operating statement from the following trial balance and data of the N Manufacturing Company as at December 31, 1936:

	Debits	Credits
Cash in bank	$ 7,209.15	
Customers' accounts	84,600.31	
Raw materials	298,934.60	
Work in process	92,020.02	
Finished stock	66,098.50	
Unexpired insurance	1,234.45	
Machinery and equipment	375,121 11	
Reserve for depreciation		$ 100,240.96
Accounts payable and accrued		64,233.25
Capital stock (20,000 shares no par)		256,488.90
Earned surplus, December 31, 1935		133,082.51
Sales		974,016.22
Cost of sales	779,115.31	
Materials absorbed		288,854.12
Direct labor absorbed		209,600.44
Factory overhead absorbed		192,832 40
Direct labor	209,600.44	
Factory overhead	186,550.05	
Salesmen's commissions	85,314 48	
Officer's salary	20,000.00	
Office rent and expense	3,376 20	
Provision for federal income taxes	10,174.18	
Totals	$2,219,348 80	$2,219,348.80

Physical inventories at cost, which was lower than market, were as follows:

	December 31, 1935	December 31, 1936
Raw materials	$17,200.50	$10,080.48
Work in process:		
Material	41,236 48	39,604.02
Direct labor	30,050.00	27,300 00
Factory overhead	27,646.00	25,116.00

	December 31, 1935	December 31, 1936
Finished stock:		
Material	62,438.33	28,850.55
Direct labor	49,650.00	19,400.00
Factory overhead	45,678.00	17,848.00

The inventory at December 31, 1935, was sold during 1936.
Machinery manufactured in 1936 for own use was as follows:

Materials	$ 3,454.63
Labor	3,800.68
Overhead	3,496.63
Total capitalized	$10,751 94

Factory overhead has been absorbed during 1936 on the basis of 92 per cent of direct labor, which was the ratio for 1935, and must be corrected to the actual ratio for 1936, by the use of a percentage without a decimal fraction.

Depreciation expense is included in factory overhead and has been computed at 10 per cent annum. The only addition to machinery and equipment during the year was the machinery manufactured for own use, which included factory overhead as above and on which depreciation of 5 per cent (one-half year) has been charged.

Federal income taxes have been estimated at 11 per cent of net income but will be approximately 30 per cent.

Problem 10

(District of Columbia, May, 1933)

From the information appearing below prepare a balance-sheet of the Goldrox Company at December 31, 1932:

Cash in bank (less checks in payment of accounts payable of $19,572.27, dated December 31, 1932, but mailed to creditors January 5, 1933)	$ 50,081 97
Petty cash (in which are included advances to employees of $575, which are to be repaid from next payroll)	1,000.00
Customers' notes (of which $15,419.50 past due are doubtful and believed to be but 50% collectible)	82,064.48
Accounts receivable (including bad accounts of $18,672.27, doubtful items—50% collectible—of $39,961.59, and advances to officers of $10,500 for stock subscriptions and of $2,514.62 on open account)	137,111 56

Inventory of—	
Finished goods (including consignments received amounting to $3,095.56)	$ 70,725.26
Work in process (excluding factory overhead of $4,604.71).	30,290 22
Raw material (merchandise in transit at December 31, 1932, not entered on books, $17,429.70)	56,977 43
Unexpired insurance premiums (in which are included the cash surrender values of $21,903.38 on officers' life insurance policies)	27,429.70
Bonds and stocks (market value of listed securities $132,055.21; unlisted stocks consist of investments at cost of $54,691.50 in affiliated companies)	194,412.93
Deposit with sinking-fund trustee from which matured but unpresented bonds of $10,250 and unpresented interest coupons of $922.50 have been deducted	32,314 13
Unamortized bond discount and expense	4,604 71
Land	121,195 02
Building	444,467 18
Equipment, including equipment in use, fully depreciated, which cost $37,429 70	231,752.66
Patents, including worthless patents costing $11,903.38 on which accumulated amortization of $9,215.29 has accrued.	132,810 48
Bank loan, on which interest of $815 has been prepaid, secured by bonds and stocks having a book value of $20,116.22	15,000 00
Subscriptions to stock in affiliated companies, payable January 1, 1934	17,000 00
Trade accounts payable (included in which are debit balances totaling $9,859.31)	56,977 43
Estimated liability on contract for raw materials canceled December 20, 1932	9,200 00
Loan from stockholder secured by assignment of notes receivable of $22,316.19	20,000 00
Interest accrued on bonds	5,416 67
Other accrued expenses	23,978 16
6½ % first-mortgage bonds, payable $5,000 semi-annually on March 1 and September 1 to March 1, 1942, when balance matures	250,000.00
7 % cumulative preferred stock authorized, par value $100	500,000 00
7 % cumulative preferred stock unissued and unsubscribed	150,000 00
No-par common stock—2,000 shares authorized and issued, including 200 shares sold to officers on which the company has advanced $10,500	200,000.00
Surplus (before providing for depreciation reserves of $180,080.34 and reserve for amortization of patents of $110,907.10 but including surplus of $25,147.78 arising from revaluation of land)	669,665.47

Problem 11

(District of Columbia, May, 1933)

From the following information construct the net-worth section of the Lloyd Manufacturing Company's balance-sheet at December 31, 1932:

1. In February, 1927, when the corporation was established under the laws of the state of Delaware, it acquired all the net assets of the Lloyd Paper Box Company. The book value of the net assets to the transferor was $602,349.88, including goodwill of $100,000. Stock authorized and issued for these net assets consisted of 40,000 shares of nonvoting no-par cumulative preferred having an annual dividend rate of 80 cents per share, payable on February 1, a stated value, as determined by the directors under the authority of the charter and by-laws, of $10 a share, and a redemption price of $12; and 20,000 shares of no-par common having a stated value of $5 per share. These shares were issued pro rata to the stockholders of the old company, 10 shares of preferred and 5 shares of common being exchanged for each outstanding $100-par-value share of the predecessor company. The excess paid-in value of $102,349.88 was credited to surplus.

2. The subsequent history of the surplus account is as follows:

Balance of earned surplus at February 1, 1927, on books of Lloyd Paper Box Company		$202,349.88
Less—portion capitalized on transfer to new company		100,000.00
Balance appearing on books of new company		$102,349 88
Net profit—		
1927 (February 1–December 31)	$ 36,423 26	
1928	29,375.87	
1929	6,391.22	
1930	2,800.17	
1931	112,647.90*	
1932	148,402.55*	186,059 93*
Amount in excess of stated value received on sale, on July 1, 1929, of 20,000 shares of newly authorized no-par preferred at $11 per share		20,000.00
Transfer from capital stock accounts, authorized by Board of Directors, under provisions of charter and by-laws on July 1, 1932—		

Reduction in stated value of preferred to $6	$240,000.00
Reduction in stated value of common to $1	80,000.00
Write-off of goodwill on July 31, 1932, authorized by board of directors	100,000.00*
Reduction in value of buildings and machinery to conform to new price levels, as reflected in report of National Appraisal Company as at July 31, 1932, as authorized by Board of Directors	102,968.23*
Additional 1932 provision for loss on 1928–1930 accounts receivable arising from debtors adjudged bankrupt in 1932, although in previous years believed solvent	49,650 37*
Balance, December 31, 1932	$ 3,671 35

* Red.

3. Among the assets at December 31, 1932, is an item of reacquired stock representing the repurchase for cash from the company's president on that date of 1,000 shares of common stock at $8 a share. It is expected that this stock will be resold during 1933.

Problem 12

(Wisconsin, November, 1934)

A fire on April 1, 1934, destroyed all office records of the Ajax Distributors, Inc., except the minute book, the customers' and creditors' ledgers, and a profit and loss statement. From the information available you are asked to prepare a balance-sheet as of the close of the business on March 31, 1934. Extracts from the minutes disclose the following facts:

On January 1, 1934

Charter granted authorizing maximum capital of $48,000, consisting of $16,000 of common and $32,000 of preferred stock of a par value of $100 per share, to be issued only on a basis of one share common to two of preferred.

Forty-four shares of the common and 88 shares preferred stock were subscribed for by the incorporators at par, and the corpo-

ration received cash for one-half the subscriptions to the common stock and the remainder in 6 per cent interest-bearing notes, payable to the corporation at its office on June 1, 1934. Land and buildings with an estimated life of twenty-five years were received in settlement of the preferred-stock subscriptions. Certificates were issued to the subscribers. The buildings were appraised at twice the value paid by the corporation, and pursuant to a resolution of the board these values were set up on the books on January 1, 1934.

The sale of $5,000 of 6 per cent five-year bonds, with semi-annual interest coupons attached, secured by deed of trust on land and buildings was authorized. Bonds in an amount equal to common stock issued were sold for cash at 95. It was provided in the trust agreement that the corporation must on the last day of each quarter set aside in a special fund equal amounts sufficient to retire the bonds sold at maturity (ignore interest) and to set up a reserve therefor.

Bought following equipment on terms of one-fifth cash and the balance in four equal payments, due on the last day of each month: store and office equipment with an estimated life of ten years, and delivery equipment estimated to last five years.

Paid insurance for one year on buildings, equipment and stock.

On March 31, 1934

Dividend of 2 per cent on outstanding stock declared, payable on April 10, 1934.

Additional information obtained from bookkeeper

Books were kept on an accrual, deferred and reserve basis. Depreciation was computed on the straight-line method with no scrap values. All items of income or expense were cash unless so indicated. All receivables and payables paid were within the discount period. A $400 sixty-day 6 per cent interest-bearing note dated March 1, 1934, was received from a customer in settlement of his account. Salaries and rent were the same each month, and March items have not been paid. Ten per cent of the outlay for advertising and store supplies for the period remained on hand on March 31, 1934. No accounts have been charged off as bad. The profit and loss statement follows:

AJAX DISTRIBUTORS, INC.
Profit and loss
Quarter ending March 31, 1934

Income from sales:			
Sales, terms 1 %/20, net/30		$15,000.00	
Sales returns		1,875.00	
Net sales			$13,125.00
Cost of sales:			
Purchases, terms 3 %/10, net/60	$8,000.00		
Purchases, returns	995.00	$ 7,005 00	
Inventory, March 31, 1934		1,000.00	
Cost of goods sold			6,005.00
Gross profit on sales			$ 7,120.00
Expenses:			
Selling—			
Sales salaries	$1,500.00		
Advertising supplies used	1,130 00		
Store supplies used	180 00		
Expired insurance—merchandise	25 00		
Expired insurance—delivery equipment	20.00		
Expired insurance—store equipment	16.00		
Depreciation—store equipment	25 00		
Depreciation—delivery equipment	62 50		
Sundry selling expenses	212 50		
Total selling expenses		$ 3,171.00	
General:			
Office salaries	$ 600 00		
Rent	750 00		
Expired insurance—office equipment	10.00		
Expired insurance—buildings	12.00		
Depreciation—office equipment	15.00		
Depreciation—buildings	44.00		
Loss on bad debts	100.00		
Sundry general expenses	116.00		
Total general expenses		1,647.00	
Total expenses			4,818.00
Operating income			$ 2,302.00
Other income:			
Purchases discount	$ 173.25		
Interest earned	35.00	$ 208.25	
Deductions from income:			
Sales discount	$ 98.25		
Interest expense	66.00		
Bond discount amortized	11.00	175.25	
Net addition to income			33.00
Total net income			$ 2,335.00

Problem 13

(New York, June, 1932)

Given the following adjusted trial balance of the Snowden Auto Sales and Garage Company, December 31, 1931, prepare whatever statement or statements appear necessary to present to the management and directors the greatest amount of information possible concerning the operation results of the enterprise:

Capital stock		$ 50,000
Land	$ 7,000	
Garage expense	4,500	
Advances to salesmen	200	
Buildings	15,000	
Storage sales		5,700
Shop equipment	1,000	
Goodwill	12,000	
Wash supplies used	300	
Parts	3,000	
Reserve for repossessions and revaluations		3,200
Prepaid expenses	600	
Service station labor	12,000	
Storage floor space rent	1,000	
Accrued liabilities		2,500
Sales of oil and grease		7,000
Tires and tubes	600	
Parts department expense	1,800	
Notes receivable discounted		9,300
Used cars	16,000	
Miscellaneous financial expense	13,100	
Customers' deposits		4,500
Service station expense	10,000	
Gasoline	150	
New car expense	46,000	
Soudan cars	12,000	
Miscellaneous financial income		4,000
Reserve for bad debts		120
Wash wages	1,200	
Sales of tires and tubes		8,000
Used car expense	12,000	
Service cars—shop	1,200	
Reserve for depreciation		3,720
Management expense	92,000	
Surplus		155,660
Storage floor wages	1,200	
Furniture and fixtures	200	

Sales of gasoline		$ 3,000
Petty cash	$ 1,000	
Wash sales		3,800
Cost of Waterbury car sales	130,000	
Accessories	400	
Cost of gasoline sales	1,800	
Mortgage payable		12,000
Sales of accessories		7,000
Cost of oils and grease sales	2,000	
Notes payable		36,000
Cost of Soudan car sales	91,000	
Cash in bank	15,500	
Sales of parts		9,000
Cost of tires and tubes sales	12,200	
Accounts payable		3,500
Cost of parts sales	5,000	
Oils and grease	100	
Waterbury cars	30,000	
Cost of used car sales	96,000	
Sales of Soudan cars		130,000
Cost of accessories sales	8,000	
Reserve with finance companies	5,150	
Sales of Waterbury cars		200,000
Notes receivable	10,000	
Cash value—life insurance	1,800	
Sales of used cars		90,000
Deferred contracts receivable	75,000	
Sales—service station		35,000
Accounts receivable	6,000	
Contracts receivable	28,000	
Totals	$783,000	$783,000

Problem 14

(New York, November, 1932)

THE BISON APPLIANCE COMPANY

Trial balance (before closing), December 31, 1931

Cash	$ 137,240	
Accounts receivable	643,000	
Reserve for bad debts	2,600	
Land	150,000	
Buildings	450,000	
Machinery and equipment	1,000,000	
Furniture and fixtures	25,000	
Reserve for depreciation—buildings		$ 222,000
Reserve for depreciation—machinery and equipment		462,000

Reserve for depreciation—furniture and fixtures.		$ 10,500
Inventory—finished goods, December 31, 1930 ..	$ 325,000	
Inventory—work in process, December 31, 1930..	275,000	
Inventory—materials, December 31, 1930...	200,000	
Stationery and office supplies....	10,650	
Unexpired insurance....	3,650	
Accounts payable....		85,000
Notes payable....		75,000
Accrued wages....		24,500
Accrued property taxes....		9,775
Capital stock, common no par....		1,000,000
Capital stock, preferred 7% cumulative $100 par value....		450,000
Surplus....		193,395
Sales....		4,000,000
Return sales and allowances.	45,000	
Materials purchased	1,750,000	
Direct labor	550,000	
Indirect labor....	306,000	
Heat, light and power ...	42,500	
Maintenance and repairs...	43,000	
Factory supplies....	77,050	
Miscellaneous factory expense	32,650	
Depreciation—buildings....	6,000	
Depreciation—machinery and equipment	62,000	
Depreciation—furniture and fixtures.	2,500	
Insurance	22,700	
Salesmen's salaries....	95,000	
Travel expenses—salesmen	15,000	
Advertising....	22,000	
Officers' salaries.	125,000	
Office salaries....	33,550	
Miscellaneous office expense	4,550	
Property taxes	15,000	
Telephone and telegraph.	3,000	
Interest paid....	12,000	
Dividends paid....	31,500	
Discounts received		75,970
Discounts allowed....	90,000	
Totals....	$6,608,140	$6,608,140

You are engaged to make an audit of the books and accounts for the year ended December 31, 1931, and you find the following conditions:

Accounts receivable in bad shape, having $15,000 known to be worthless and $19,000 on which it is expected to realize 40 per

cent. Of these bad accounts $17,000 arise from sales in prior years. The 1931 write-offs relate to prior years.

Inventories, December 31, 1931, are as follows:

Raw materials	$420,000
Factory supplies	19,750
Work in process	375,000
Finished goods	425,000

Cash received in January, 1932, from accounts receivable collections amounting to $27,000, was included in December, 1931, as cash on hand.

Inventories of finished goods and work in process contain the following items of cost:

	1931	1930
Labor	$160,000	$150,000
Materials	390,000	320,000
Factory overhead	250,000	130,000

Overhead has been distributed on the basis of direct labor, the cost records showing the following:

	Actual direct labor	Actual overhead	Rate used in cost records
1930	$330,000	$510,000	140%
1931	550,000	587,150	150%

Depreciation was taken at the following rates:

Buildings 2 per cent, machinery and equipment 10 per cent, furniture and fixtures 10 per cent.

These rates are applied to actual cost of property. There were no additions to properties during the year, but an appraisal made as of the beginning of the year has been reflected on the books.

Required:

1. Balance-sheet, December 31, 1931.
2. Detailed statement of income and profit and loss for the year ended December 31, 1931.

Problem 15

(New York, April, 1934)

Required: Prepare balance-sheet, income and expense statement and analysis of surplus.

The Howard Manufacturing Company was organized under the laws of New York, November 1, 1931, with an authorized capital stock of $1,750,000, of which $500,000 was 6 per cent preferred and $1,250,000 common. The company also was authorized to issue bonds in the amount of $350,000, due January 1, 1942, bearing 5 per cent interest, payable semi-annually.

At its organization, assets were acquired from Floyd & Klein in consideration of the issuance of $500,000 par-value common stock and $150,000 preferred stock as follows:

Real estate—plant site......	$ 75,000
Real estate—Greenwood block	50,000
Buildings........	200,000
Machinery and equipment	150,000
Goodwill..........	125,000
Patents (date of issue January 1, 1931)	90,000
	$690,000

On the Greenwood block there was a mortgage of $22,000, due June 30, 1935, which was assumed by the purchaser. This mortgage bears interest at 6 per cent, payable annually in June. The purchaser also assumed accounts payable of $18,000.

Floyd & Klein donated back to the company common stock in the amount of $125,000, to be used as a bonus in the sale of preferred stock.

Following the organization, preferred stock in the amount of $175,000 was sold for cash at par, and bonds of a face value of $200,000 were sold at 90. Subsequently, $125,000 par value of preferred stock was sold to net $95 per share.

In addition to the foregoing you find that:

1. No record of the common stock donated by Floyd & Klein has been placed on the books.
2. The preferred stock and bonds have been entered at the amount for which sold.
3. Cash is short $4,500.
4. No reserve is provided for accounts receivable—one-half of 1% of year's sales considered reasonable.
5. Investments consist of government bonds $40,000 (4¼ per cent interest, due December 15 and June 15), December coupons attached, and stock in a newly organized company of a par value of $25,000 carried at cost, $21,250, representing a 25 per cent interest in that company.

6. In the accounts receivable there is an account against this same company amounting to $18,500, representing advances made to it to be repaid in raw materials when that company begins operations, and advances of $12,500 made to corporate officers.
7. Additions have been made to building and machinery during the year as follows:

Buildings	$25,000
Machinery and equipment	12,500
Office furniture and fixtures	4,500

No depreciation has been provided for on the books, but rates have been agreed to as follows:
Buildings 2½ per cent on the original purchase price plus one-half the additions for the year.
Machinery 12½ per cent on the original purchase price plus one-half the additions for the year.
Office furniture and fixtures 10 per cent on the balance in the accounts December 31, 1932.
Greenwood property 3 per cent on book value.

8. No provision has been made for amortization of patents, which have a life of 16 years from January 1, 1932.
9. Amortization of bond discount may be ignored.
10. No provision has been made for the following accruals and prepayments:

Accruals	
Payroll—productive labor	$ 7,500
Nonproductive labor	500
Salesmen's commissions	15,000
Taxes	3,300
Interest payable	2,250
Interest receivable on notes and bonds	1,200
Prepayments	
Insurance—factory	$ 1,500
General	900
Taxes	250
Interest	750

11. Notes receivable have been discounted in the amount of $18,500.
12. Contracts have been let for new machinery to the amount of $100,000; no deliveries, however, have yet been made.
13. An inventory showed supplies on hand $2,500.

The Howard Manufacturing Company
Trial balance, December 31, 1932

Cash	$ 75,500	
Notes receivable	15,500	
Accounts receivable	275,000	
Inventory of raw materials	85,000	
Inventory of work in process	175,250	
Inventory of finished goods	87,500	
Investments	61,250	
Buildings	225,000	
Machinery and tools	162,500	
Office furniture and fixtures	4,500	
Real estate—plant site	75,000	
Real estate—Greenwood block	50,000	
Patents	90,000	
Goodwill	125,000	
Notes payable		$ 130,000
Accounts payable		45,000
Mortgage payable		22,000
Bonded debt		180,000
Reserve for overhead		125,000
Capital stock, preferred		443,750
Capital stock, common		500,000
Sales		1,450,000
Cost of goods sold	950,000	
General office expense	4,750	
Office salaries	15,000	
Printing and stationery	6,500	
Salaries of officers	45,000	
Insurance	1,650	
Taxes	3,900	
Nonproductive labor	58,500	
Superintendence	15,000	
Heat, light and power	25,000	
Repairs—buildings and machinery	20,500	
Insurance—buildings and machinery	2,700	
General factory expense	9,200	
Supplies	21,450	
Salesmen's salaries	60,000	
Salesmen's commissions	48,000	
Advertising	90,000	
Printing, stationery and postage	2,100	
Discount on purchases		14,650
Interest received		1,000
Rental received		3,600
Discount on sales	18,000	
Interest paid	9,250	
Expenses—Greenwood block	1,500	
Totals	$2,915,000	$2,915,000

THE HOWARD MANUFACTURING COMPANY
Analysis of operating accounts
Raw material

Purchases	$ 625,250
Transfer to work in process—actual cost	487,250
On hand December 31, 1932—actual cost	$ 138,000

Work in process
Debits

Raw material from stores—actual cost	$ 487,250
Productive labor from payrolls	575,250
Overhead 20% of productive labor	115,050
	$1,177,550

Credits

801,840 units transferred to finished goods accounts at estimated cost of $1.25 per unit	$1,002,300
38,500 units on hand December 31, 1932, in half-stage completion	175,250
	$1,177,550

Finished goods

801,840 complete units transferred from work in process at estimated cost of $1.25	$1,002,300
760,000 complete units transferred to cost of goods sold at estimated cost of $1.25	950,000
Balance, December 31, 1932	$ 52,300

Problem 16

(Ohio, November, 1934)

The Manufacturing Company has engaged you to audit its books for the year ended December 31, 1933.

The petty cash fund, recorded as amounting to $500, was counted on January 15, 1934, and consisted of the following:

Cash	$200
Advance to secretary dated December 28, 1933	170
Freight bill—paid January 5, 1934	12
Office supplies—paid December 29, 1933	18

The company's records indicated that $40,000 was on deposit in United States banks ($10,000 of which was in closed banks on which the passbooks were quoted at 50) and $30,000 on deposit in a foreign country for which the exchange rate was 102.

In auditing the cash for the year you discover that a check for $25,000, dated August 25, 1933, payable to the president of the company had not been entered. The canceled check, properly

endorsed, was in the files, and the president informed you that it was in payment of common stock of the company. No authorization of such purchase was recorded in the minute book, and the stock was not submitted to you for inspection.

Securities owned were on hand and consisted of listed bonds with a book value of $50,000 and a market value of $40,000, and sundry stocks with a book value of $20,000 on which no market values were available. The sundry stocks included a $10,000 investment in a fully owned subsidiary, organized January 1, 1932, which has a net worth of $2,000. The operations of the subsidiary resulted in a profit of $4,000 in 1932 and a loss of the same amount in 1933. A dividend of $4,000 was paid each year.

Accounts receivable amounted to $150,000 and included consignment accounts of $20,000 which were credited to sales at 10 per cent in excess of cost and employees' accounts aggregating $2,000 for merchandise sold to them. Notes amounting to $8,000, accepted in payment of accounts, were examined on January 15, 1934, but you find that such notes are not entered on the company's books. You were informed that other notes had been paid during January, 1934, but no determination of the amount thereof could be made. Ninety per cent of the company's product is sold to one concern which owed the company $115,000 at December 31, 1933. Information obtained by you indicated that the reserve of $5,000 provided for doubtful accounts was sufficient. This reserve was provided in prior years, and no amount was charged against operations for 1933.

The inventory at December 31, 1933, consisted of the following:

Raw materials	$40,000
In process and finished:	
Material	30,000
Labor	10,000
Burden:	
Factory	8,000
Administrative (proportion)	2,000
Supplies	5,000

The finished inventory includes 17,000 washing-machine parts at a valuation of $12,750. The inventory at the beginning of the year contained 18,000 of such parts, valued at $10,800. Two thousand were manufactured during the year at a cost of $1,500, and 3,000 parts were sold.

Additions to plant accounts amounted to $26,000 in 1932 and $10,000 in 1933. A reserve of $10,000 has been provided for depreciation.

Annual premium of $3,200 was paid November 30, 1933, on fire insurance policy dated October 31, 1933. Life insurance on officers, in the amount of $50,000, is carried, and the annual premium of $1,500 was due on November 30, 1933, and paid on January 15, 1934.

Accounts payable and accrued items consist of $35,000 due for purchases and expenses, $2,500 due officers, payrolls $6,500, federal income taxes $3,000, royalties $1,600. A lawsuit for $5,000 for patent infringement has been filed against the company.

The company issued ten-year 6 per cent debentures in the amount of $50,000 dated January 1, 1932. The sinking-fund provisions require a payment of $2,000 semi-annually, the first payment to be made on June 30, 1932. Three payments have been made. The company is also required to pay $1,500 semi-annually to the trustee to cover interest requirements. The first payment was made on June 30, 1932, and two subsequent payments have been made. The bonds are convertible into capital stock of the company on the basis of 500 shares for each $1,000 bond. Bonds amounting to $5,000 were converted on July 1, 1933.

The company's authorized capital stock consists of 100,000 shares without par value. The stated capital of $100,000 was entered on the books January 1, 1932, for 50,000 shares issued in payment of the company's plant.

A dividend of 10 cents a share was declared on December 28, 1933, payable January 2, 1934.

Required:

1. Balance-sheet as of December 31, 1933, properly classified.
2. Journal entries and explanations.
3. Write audit report explaining your verification of the various assets and liabilities.

Problem 17

(American Institute of Accountants, May, 1933)

From the following trial balance and supplementary information, you are to prepare a balance-sheet, as at December 31, 1932,

and the related profit-and-loss account for the year ended that date. Formal journal entries are unnecessary.

The balance-sheet is to be prepared for a certain creditor, who has guaranteed the payment for your services, and you are requested to make all necessary adjustments, regardless of amount, and to give effect through such adjustments to transactions, valuations or reclassifications which would affect the financial position of the company, rather than through the use of footnotes or qualifications.

General Furniture Company
Trial balance, December 31, 1932

	Dr.	Cr.
Cash	$ 100,000	
Notes receivable—trade	150,000	
Accounts receivable—trade	650,000	
Reserve for bad debts		$ 55,000
Inventories	750,000	
Advances and loans	50,000	
Investments	150,001	
Prepaid insurance and other expense	22,550	
Cash-surrender value of life insurance policy	5,000	
Land	500,000	
Buildings	730,000	
Equipment	350,000	
Reserve for depreciation		195,000
Notes payable—American City State Bank		550,000
Drafts payable		5,000
Accounts payable		420,000
Accrued interest, wages, taxes, etc		40,000
Note payable—J. B. Lee		50,000
First mortgage bonds, 6 per cent. due June 1, 1938		500,000
Capital stock—13,000 shares of $100 par value each		1,300,000
Unissued capital stock	57,450	
Surplus		575,001
Sales		2,000,000
Cost of sales	1,500,000	
Selling expense	400,000	
Administrative expense	150,000	
General expense	100,000	
Interest paid	32,500	
Interest received		7,500
Totals	$5,697,501	$5,697,501

An analysis of the accounts discloses that cash is composed of

Working funds	$ 8,000
Balance in First National Bank (closed October 15, 1932)	1,000
Balance in First State Bank (closed December 15, 1932)	3,500
Balances in other banks	90,000
Total	$102,500
Deduct: Overdraft in Second State Bank account	2,500
Net cash balance—per trial-balance	$100,000

NOTE.—Make no provisions for loss on balances in closed banks.

Notes comprise $30,000 due in 1933, $35,000 due in 1934, and $85,000 due in 1935. All these notes are pledged against a bank loan.

Inventories consist of raw material and supplies to the amount of $150,000 and finished product to the amount of $600,000. Raw material and supplies are valued at the lower of cost or market, and finished product at cost as determined by the company. Upon investigation it is found that, due to low production, overhead expenses are abnormally high and that if the company's cost had been so calculated as to include an overhead rate based on normal production, the overhead included in the inventories would be reduced by $100,000.

Investments comprise	
Listed bonds, at cost	$140,000
Stock of A B Lumber Co., at cost	10,000
100 shares ($100 par value each) of First National Bank stock, at the nominal value of	1
Total	$150,001

The market value of the listed bonds is found to be $120,000. There is no trading in the stock of A B Lumber Co., but from a balance-sheet of that company submitted to you, it is ascertained that the cost at which this stock is carried is not in excess of the book value thereof, as shown by the balance-sheet of the A B Lumber Co.

Advances and loans, at December 31, 1932, consist of a loan with interest paid to December 31, 1932, to Adams Chemical Co., of $50,000, against which 700 shares of the capital stock of General Furniture Co. were held as collateral. These 700 shares had a market value at December 31, 1932, of $80 per share. The loan became due December 30, 1932, and under date of January

10, 1933, the Adams Chemical Co. stated that it was unable to reduce the loan or to provide additional collateral and assented to the forfeiture of the 700 shares of collateral stock in cancellation of the indebtedness.

An examination of the advances-and-loans account discloses that the president, J. A. Stewart, had paid off a loan (carried since June 1, 1930) of $25,000 on December 27, 1932, and that on January 6, 1933, a loan of the same amount was again made to Mr. Stewart.

The company is carrying a life-insurance policy, of the face value of $100,000, on the life of the president, the cash-surrender value of which at December 31, 1932, was $5,000. This policy was pledged under the indenture securing the company's bond issue.

The American City State Bank has confirmed its loans to the company in the amount of $550,000. Collateral held by the bank consisting of bonds, notes receivable and accounts receivable, has been found to agree with the company's record, and to comprise all of its bonds and notes receivable, and $200,000 of its accounts receivable.

Drafts payable in the amount of $5,000 represent outstanding drafts of the company, used in lieu of bank cheques to avoid federal taxes, in a form approved by the company's counsel for this purpose.

The note payable in favor of J. B. Lee, vice-president of the company, has been confirmed by Mr. Lee. It is a demand note, dated June 1, 1930, bearing interest at the rate of 5 per cent. Interest on this note has been paid, or accrued, by the company to December 31, 1932.

Unissued capital stock, shown on the trial-balance in the amount of $57,450, is found to represent 400 shares of unissued stock and 200 shares of reacquired stock at a cost of $17,450. The acquisition of 700 shares of collateral, forfeited by Adams Chemical Co., has not been recorded on the books.

NOTE.—In preparing your balance-sheet, do not carry any treasury stock on the asset side thereof.

Undistributed profits to December 31, 1931	$405,000
Surplus arising from appraisal of properties, December 30, 1928, less depreciation thereon to December 31, 1932	150,000
Premium on sale of capital stock	30,000
Credit for plant site donated by chamber of commerce in 1920	25,000
Total	$610,000

Deduct:

Write-down of inventory of new line of cabinets introduced in 1932	$25,000	
Write-down of First National Bank stock	9,999	34,999
Balance		$575,001

Commitments for the purchase of materials at December 31, 1932, [illegible] $100,000, for which the market price, at that date, was $90,000.

Problem 18

(Ohio, May, 1935)

The president of The Silk and Linen Thread Company submitted the following balance-sheet, as of December 31, 1934, to the First National Bank for the purpose of securing a renewal of the $240,000 loan. It was agreed that the loan would be renewed if the company would submit a certified balance-sheet without qualification that reflected these values:

Assets		*Liabilities*	
Cash	$ 3,000	Notes payable	$ 240,000
First National Bank	25,000	Accounts payable	20,000
Certificate of deposit	4,000	Accrued interest on	
Notes receivable	3,000	bonds	6,000
Accounts receivable	280,000	Accrued taxes	3,000
Finished goods	250,000	Federal income tax	15,000
Work in process	90,000	Accrued payroll	4,000
Raw materials	130,000	First-mortgage 6%	
Prepaid rent	1,000	bonds due January	
Prepaid interest	3,600	15, 1937	100,000
Unexpired insurance	4,400	Reserve for bad debts	
Stocks owned	50,000	—accounts receivable	20,000
Bonds owned	100,000	Reserve for depreciation	200,000
Sinking-fund trustee:		Reserve for sinking fund	56,000
Cash	16,000	Capital stock—authorized	
Securities	40,000	8,000 shares, no	
Plant and equipment	900,000	par	1,000,000
		Surplus	236,000
Total	$1,900,000	Total	$1,900,000

You were retained to make the audit which was begun January 15, 1935.

In verifying the bank balance, you noted that a check for $30,000, payable to cash and signed by the president, was charged to advertising. The minutes did not authorize this expenditure.

The notes receivable were long past due. The credit manager assured you that collection would be made.

In vouching the journal entries, you noted an entry dated December 31, 1934, charging accounts receivable control and crediting sales, $200,000. The entry was not posted to the customers' ledgers. You found that a $10,000 check received from a customer had not been credited or entered anywhere on the books. A photostatic copy of the check obtained from the customer showed that it had been endorsed for the company in blank in the handwriting of the president. Checks amounting to $15,000 had been credited to customers' accounts but were not entered in the cash-receipts record or deposited in the bank.

The shipping records showed but few shipments since December 31, 1934. The work in process at that date had been completed by January 15, 1935, and stored in the warehouse. On the finished goods inventory sheets were listed 15,000 cases of linen thread at $10 per case and 5,000 cases of silk thread at $20 per case. You were unable to account for 3,000 cases of linen and 2,500 cases of silk thread. The raw materials inventory sheets listed, among other items, 1,000 bales of cotton at $100 per bale. Reference to purchase invoices indicated that cotton was worth $50 per bale at December 31, 1934. A folder containing unpaid invoices of $200,000 was found by you in the purchasing department. These invoices for 1934 purchases were not entered on the books at the close of the year.

A list of the stocks and bonds follows:

Issue	Par value	Cost value	Market December 31, 1934
Stocks:			
General Motors	$ 10,000	$ 22,000	$ 23,000
Manhattan Shirt	25,000	10,000	12,000
Associated Dry Goods	15,000	8,200	7,500
Totals	$ 50,000	$ 40,200	$ 42,500
Bonds:			
U. S. Treasury 4's	$100,000	$100,000	$108,000

At the time the securities were verified, there were $10,000, U. S. Treasury 4's missing from the safe deposit box. You were told by the president, who was the only person having access to

the box, that these bonds were sent in to be registered and that the registered bonds had not been returned. Several days later he handed you two $5,000 U. S. Treasury 4's and explained that he had decided not to have them registered.

On December 31, 1934, the plant and equipment was arbitrarily written up, and capital stock credited $200,000.

Required: Submit corrected balance-sheet and audit report, explaining briefly the verification of the assets, liabilities and capital.

Problem 19

(Pennsylvania, November, 1936)

The directors of the Production Manufacturing Company, a new client, have requested you to certify its balance-sheet, presented to you as follows:

Balance-sheet, November 1, 1936

Assets

Current assets:		
Cash in bank and on hand	$ 50,000.00	
Cash in closed bank	12,000.00	
Accounts and notes receivable	170,000 00	
Inventories	250,000 00	
Total current assets		$ 482,000 00
Fixed assets:		
Land, buildings and equipment	$ 830,000.00	
Patents and trade-marks	100,000.00	
Total fixed assets		930,000.00
Investments		200,000 00
Deferred charges		145,000.00
Total		$1,757,000.00

Liabilities and capital

Current liabilities:		
Notes payable	$ 84,000 00	
Accounts payable	95,000.00	
Accrued taxes	10,500 00	
Accrued interest	4,500.00	
Total current liabilities		$ 194,000 00
Mortgage payable		150,000 00
Capital stock and surplus:		
Capital stock	$1,250,000.00	
Surplus, November 1, 1936	163,000.00	
Total net worth		1,413,000.00
Total		$1,757,000.00

Your examination, made for the purpose of certification, developed the following facts with respect to the foregoing balance-sheet.

Cash includes:
- Postdated checks of customers in the sum of $3,750.
- Checks (in payment of accounts payable) listed as outstanding but still on hand, $12,250.
- Closed bank holding $12,000 will ultimately pay in full.

Accounts and notes receivable:
- Notes of companies in which officers are interested, which have 18 months to run, $25,000.
- Officers' and employees' advances of $2,000.
- Notes of customers, $3,500 which are all past due.
- Accounts totaling $15,000 representing consignment shipments billed at cost.
- About one-third of customers' accounts are past due.
- The customers' accounts included are shown net of the reserve of $15,255, or 13½ per cent for bad accounts.
- Notes of customers for the sum of $10,000 maturing subsequent to November 1, 1936, have been discounted with banks.

Inventories of $250,000 include:
- Flasks and patterns revalued at $75,000 by reason of use in production.
- Merchandise received on consignment at billing of $15,000 to be paid for as used in connection with own production.
- Raw material, work in process and finished goods are carried at cost.

Fixed assets:
- Land which cost $15,000 was written up after purchase to $30,000.
- Buildings and equipment are shown net after depreciation of 20 per cent of their cost.
- Patents and trade-marks are net after amortization to October 31, 1936.

Investments include:
- 10,000 shares of treasury stock acquired in July, 1936, in return for cancellation of amounts totaling $80,000 due from officers, at which sum the shares are carried on the

books. The minutes indicate that these shares are to be retired.

350 shares of stock of the Ibid Company acquired at par of $100 per share and carried at $35,000. All the remaining $65,000 of capital stock of this company is owned by officers of the Production Manufacturing Company.

1,000 shares of stock of the Simplex Pattern Company acquired at $5 per share, being all the outstanding stock of that company, whose financial statement shows a book value of $7.50 per share as compared with the par value of $10 per share.

Various listed stocks having a market value of $37,000 acquired and carried at cost, viz., $51,000.

United States Treasury bonds having a par value of $25,000 acquired and carried on the books at 101. The market value at November 1, 1936, was 103.

Cash-surrender value of $50,000 policy on life of the president of the Production Manufacturing Company was $3,750.

Deferred charges include:

Unexpired insurance premiums of $3,450.

Organization expense of $1,550.

Cost of disallowed patent applications $40,000.

Goodwill setup in connection with organization of the company, $100,000.

Notes payable include:

Past due notes to creditors for $24,000.

Demand notes of $15,000 given to officers for salaries.

Notes to bank for $45,000 which are secured by collateral in the form of the listed stocks and U. S. Treasury bonds owned by the company.

Accounts payable include:

Payroll of $8,000 for period ended October 31, 1936.

Credit balances of $12,000 in employees' accounts.

Advances of $15,000 on customers' sales contracts not yet billed or produced.

Accrued taxes and interest were correct as shown.

Mortgage payable:

This is a 6 per cent mortgage for $150,000 dated May 1, 1931, payable $2,500 at each semi-annual interest date.

Interest has been paid or accrued to October 31, 1936, but no payments have been made on the principal.

Capital stock:

The company has a Pennsylvania charter dated January 1, 1931. The authorized capital stock consisting of 100,000 shares having no par value was all disposed of at $15 per share. The minutes specify that the stated value per share is $10.50

Surplus:

The company has been in operation since January 1, 1931, and showed an aggregate loss of $103,000 for the years 1931 to 1934 inclusive. In 1935 a profit of $14,000 was made; and for 1936 to date, a profit of $12,000.

A dividend of 25 cents per share was paid in 1935; and on October 15, 1936, a dividend of 15 cents was declared and made payable November 15, 1936.

Required: Prepare a balance-sheet to which you can properly certify, limiting yourself to two simple footnotes and making any other necessary explanatory notes as briefly as possible immediately adjoining the various items in the balance sheet. The balance sheet is to be all-inclusive; that is to say, exhibits or references thereto as accompanying the balance sheet are not acceptable. (The certificate itself is not required as part of the solution of this problem.)

Problem 20

(American Institute of Accountants, May, 1937)

From the following data prepare a work sheet showing the adjustments and the segregation between balance-sheet, profit-and-loss, trading and manufacturing account:

The Enterprise Manufacturing Company commenced business on July 1, 1934, and, its fiscal year being the calendar year, closed its books on December 31, 1934, but no audit was made.

The second closing was to be as of December 31, 1935, at which time the assets and liabilities were to be verified and the books audited. The following trial balance of that date was drawn off the books and submitted:

	Dr.	Cr.
Accounts payable—trade	$	$ 180,000
" " —officers		20,000
Accounts receivable—trade	270,000	
Advances to employees	35,000	
Advertising	40,000	
Auto trucks	40,000	
" " —depreciation		5,000
Bond interest	3,500	
Bonds—7% dated June 30, 1935		100,000
Buildings	240,000	
" —depreciation		3,600
Capital stock—5,000 shares common		500,000
" " —1,000 shares 7% preferred		100,000
Cash in bank	60,000	
" —work fund	1,000	
Catalogs and circulars	5,000	
Charity	2,000	
Coal—factory	28,000	
Collection	1,500	
Discount—allowed	24,000	
" —taken		11,000
Dividends—common	19,200	
" —preferred	3,500	
Engineering	6,000	
Experimental expenses	7,000	
Freight—inward	20,000	
" —outward	36,000	
Furniture and fixtures	6,000	
" " " —depreciation		300
Gasoline and auto—salesmen	19,000	
Goodwill	100,000	
Horses	2,500	
Interest—earned		2,500
" —paid	4,000	
Insurance—factory	3,500	
Inventory—raw material	80,000	
" —in process	60,000	
" —finished	100,000	
Labor—direct	360,000	
" —indirect, including factory clerks	160,000	
Legal and accounting	18,000	
Liability insurance—factory	9,000	
Light and heat—factory	15,000	
" " " —office	1,500	
Machinery and equipment	200,000	
" " " —depreciation		9,000

	Dr.	Cr.
Notes payable		$ 50,000
" receivable—trade	$ 40,000	
" " —employees	8,000	
Office stationery and supplies	2,000	
Patents	25,500	
" —depreciation		750
Power	26,000	
Premiums on officers' life insurance	9,000	
Purchases of raw material	450,000	
Real estate—factory	50,000	
" " —outside	10,000	
Repairs—machinery	20,000	
Returns and allowances	15,000	
Salaries—executive	40,800	
" —general office	61,200	
" —salesmen	51,000	
" —superintendents	10,200	
Sales—finished goods		1,800,000
" —scrap and junk		2,000
Supplies	80,000	
Surplus		213,750
Taxes—municipal	16,000	
" —federal	1,000	
Tools—manufacturing	60,000	
" — " —depreciation		5,000
" —perishable	25,000	
Treasury stock—common	22,000	
Totals	$3,002,900	$3,002,900

Physical inventories were taken at December 31, 1935, but have not yet been brought upon the books. The auditor has ascertained that they were valued on the same basis as at the beginning of the year and after the usual tests and verification he has accepted them as correct, viz:

Raw materials	$ 75,000
Work in process	80,000
Finished goods	120,000
Supplies	8,000
Coal	4,000
Perishable tools	6,000
Horses	2,000
Catalogs and circulars	1,800

In the course of the examination it was found that depreciation had been provided to December 31, 1934, at the following annual rates, applied to the opening balances:

Auto trucks	25%
Buildings	3%
Furniture and fixtures	10%
Machinery and equipment	10%
Tools—manufacturing	20%

Method and rates have been approved by the auditor and he intends to provide depreciation on the year's additions at one half of the above rates. The patents are being amortized in 17 years.

During 1935, $20,000 was spent for new machinery and $10,000 for manufacturing tools. Both amounts were capitalized. Furthermore $4,000 was spent for additional machinery but was inadvertently charged to repairs.

The trade accounts receivable included uncollectible balances aggregating $10,000.

The cash surrender value of insurance policies taken out by the company on the lives of officers was $800.

A semi-annual dividend had been declared on the preferred stock, payable on January 1, 1936; also $8 per share on the common stock payable on that same date.

Property taxes had accrued to the amount of $2,000 on December 31, 1935, and $1,800 had accrued on December 31, 1934.

Two months' interest at 6% per annum had accrued on the $50,000 notes payable. The latter represented the balance of a four-months' bank loan of $200,000 procured on July 1, 1935, and reduced to the present amount on October 31, 1935.

Wages and salaries had accrued as follows:

Labor—one week's payroll	
Direct	$6,000
Indirect	1,000
Salaries—two weeks	
Executive	1,600
Office	2,400
Salesmen	2,000
Superintendents	400

In 1934 all wages had been paid up to the end of the year, but on the other hand one week's salaries, amounting to one half of the above amounts, remained unpaid.

The unexpired fire-insurance premiums amounted to $600 at the end and $400 at the beginning of the year.

The $1,000 federal taxes represent the federal capital-stock tax paid on a declared value of $1,000,000 of the capital stock as at June 30, 1935. The federal taxes for 1934 had been paid and no consideration need be given to their possible adjustment on account of changes in the January 1, 1935, surplus. The 1935 federal income tax must be computed at the 1935 rate of 13¾% of the taxable income, and the excess-profits tax at that year's rate of 5%, taking into consideration that 12½% of the declared value of the capital stock is exempt.

Two hundred shares of its capital stock had been taken over by the company at $110 per share in settlement of an outstanding account receivable. The stock is locally quoted at $125 per share.

Problem 21

(Pennsylvania, November, 1936)

You are engaged on December 10, 1935, by the Textile Spinning Company, a corporation operating a spinning mill, to prepare statements reflecting the financial condition as at November 30, 1935, and the result of operations for the eleven months then ended, with particular reference to profit or loss before interest and depreciation, for submission in support of a loan application. Banks holding notes of the company have agreed to subordinate their notes to the proposed loan. The books were last closed on December 31, 1934, are kept on the accrual basis and have been posted to November 30, 1935. Cost accounts and perpetual-inventory accounts are maintained in the general ledger. There are no subsidiary ledgers except accounts receivable and accounts payable. The following trial balance of the general ledger was taken at November 30, 1935:

	Debits	Credits
Cash in bank	$ 11,461.20	
Petty cash	286.98	
Accounts receivable—trade	45,594.65	
Accounts receivable—officers	17,710.49	
Accounts receivable—employees	1,146.28	
Inventory—raw material	414.33	
Inventory—work in process	753.90	
Inventory—mill waste	382.68	
Inventory—finished yarns	5,706.92	
Building and loan association shares (cost)	1,014.80	
Rayon development	4,602.40	
Treasury stock (280 shares preferred) (cost)	28,000.00	
Goodwill	1.00	
Land (cost)	25,000.00	
Buildings (cost)	87,628.13	
Machinery and equipment (cost)	159,548.82	
Prepaid insurance		$ 459.70
Prepaid interest	9.67	
Notes payable—banks		132,648.80
Accrued wages	393.65	
Accrued taxes		103.07
Accrued interest on mortgage		230.00
Accrued salaries		1,780.01
Accounts payable		2,356.07
Mortgage payable		10,000.00
Preferred stock (1,000 shares, par $100 each)		100,000.00
Common stock (500 shares, par $100 each)		50,000.00
Reserve for depreciation—buildings		31,891.44
Reserve for depreciation—machinery and equipment		112,071.59
Deficit	18,115.88	
Distribution of overhead expenses		50,039.13
Cost of raw material used	14,591.44	14,591.44
Cost of mill waste used	353.20	353.20
Cost of imported rayon yarn used	513.19	513.19
Cost of finished yarn manufacturing	61,461.08	61,461.08
Cost of goods sold	65,394.97	
Bad debts written off	12,161.15	
Discount on sales	316.32	
Wool oil purchases	225.41	225.41
Wool scouring	639.98	639.98
Raw stock dyeing	14.40	14.40
Inbound transportation	440.27	
Payroll	17,762.80	18,156.45
Superintendence	8,202.20	
Direct labor	9,612.90	
Power and light	2,047.86	

	Debits	Credits
Insurance	$ 987.62	
Taxes—real estate	109.77	
General factory expense	2,363.83	
Laboratory expense	312.00	
Shipping supplies	84.07	
Heat	1,711.40	
Mill supplies	33.79	
Repairs—building and machinery	211.12	
Salaries—sales	3,965.51	
Traveling expense	4,016.60	
General administrative expense	2,241.00	
Taxes—capital stock	337.23	
Office expense	1,021.99	
Telephone and telegraph	541.76	
Depreciation—buildings	2,969.09	
Depreciation—machinery and equipment	5,177.73	
Interest on mortgage	450.00	
Sales		$ 37,289.04
Miscellaneous income		406.90
Interest earned		2,812.56
Totals	$628,043.46	$628,043.46

Questions 1 to 6:

1. Which accounts in the trial balance reveal an unusual condition as regards balance?
2. What method should you use to analyze cost accounts?
3. List the accounts that would be eliminated by adjusting entries on your working trial balance as a result of such analysis.

   Your audit discloses the following facts requiring adjustment:

   a. Journal entry debiting payroll $393.65 and crediting accrued wages was posted erroneously with the accounts reversed.

   b. In 1934 legal expense was debited, and accounts payable credited, in the amount of $1,000 for attorney's fees in connection with the settlement of an account receivable. The gross amount of the settlement was entered in cash receipts in 1934, although the attorney deducted his fee when remitting the proceeds.

   c. Invoice for fire insurance premiums, $459.70, has not been entered upon the books. The policy has been entered in

the insurance record, and the proper amount charged to insurance and credited to prepaid insurance, monthly. All insurance is one-year term, expiring November 30.

d. The accounts payable control has exceeded the detail by $954.90 for six years, without change.

e. Cash, $8,356.64, on deposit in a closed bank, was applied by the bank against notes payable.

f. Employees accounts receivable includes $310 due from an officer of the company.

g. Accounts payable not entered at November 30, 1935, comprise invoices for the following:

General factory expense	$ 69.89
Mill supplies	58 73
Raw wool	472.43
Heat	290.68
Total	$891.73

h. Petty cash includes vouchers for general administration expenses totaling $240.

i. Motor trucks, fully depreciated and discarded, are included in fixed assets at cost of $4,888.

j. Interest aggregating $2,812.56 was accrued on an account receivable of doubtful collectibility and charged to accounts receivable.

k. Accrued salaries comprise erroneous accruals of sales salaries, $1,480.02, and superintendence, $299.99.

l. Accrued interest payable on mortgages, not on books, amounts to $203.33.

m. Undistributed wages at November 30, 1935, comprise:

Superintendence	$141 70
Labor	219 20
General factory expense	32.75
Total	$393.65

n. Accounts receivable aggregating $8,914.75 are to be written off as uncollectible.

o. General administrative expense includes salaries of $1,500.

4. Prepare the adjusting journal entries, without explanations. The composite journal entries affecting cost and inventory accounts during the period were as follows:

	Debits	Credits
Work in process	$66,377.35	
Distribution of overhead expenses		$50,039.13
Inventory—mill waste		.30
Cost of raw material consumed		14,591.44
Cost of imported rayon yarn used		513.19
Cost of waste used		353.50
Wool oil purchases		225.41
Wool scouring		639.98
Raw stock dyeing		14.40
Cost of finished yarn manufacturing	61,461.08	
Work in process		61,461.08
Yarn inventory	61,461.08	
Cost of finished yarn manufacturing		61,461.08
Cost of goods sold	65,394.97	
Yarn inventory		54,778.79
Work in process		4,015.43
Yarn inventory (write down from cost to market)		6,600.75

5. Prepare the adjusting entries, without explanation, required for your working trial balance, to permit preparation of profit and loss statement.

The following notes on the audit are to be considered:

Cash in bank—$1,431.34 is in closed banks.

Doubtful trade accounts receivable total $27,484.55.

Doubtful employees accounts receivable total $363.65.

Accounts receivable—officers—comprise advances to be repaid out of future salaries or dividends.

Rayon spinning is a new line developed within the last year.

Extension agreements in the aggregate amount of $124,292.16 have been executed by notes payable creditors who have also waived interest.

$53.33 of interest on mortgage payable is applicable to prior year.

All bad debt losses arose from sales of prior years.

Raw material purchases during the period aggregated $12,066.51. Imported rayon yarn sold cost $513.19, with no rayon yarn purchases during the period.

Mill waste transferred from work in process to inventory—mill waste during the period aggregated $646.94.

Inventories at beginning and end of the period were as follows:

	January 1, 1935		November 30, 1935	
Raw material:				
Wool	$3,192.42		$ 721.13	
Rayon	219.27		165.63	
		$3,411.69		$ 886.76
Mill waste		89.54		382.98
Work in process		500.00		753.60
Finished goods:				
Yarn inventory	$5,070.00		$5,151.54	
Imported rayon yarns	1,068.57		555.38	
		6,138.57		5,706.92

6. Prepare statements of assets and liabilities, manufacturing, trading, profit and loss, and deficit account. You may assume that receivables and payables have been verified by correspondence, that inventories are correct and priced at cost or market, whichever is lower, and that depreciation, prepayments and accruals, not commented upon heretofore, have been properly calculated.

Problem 22

(Pennsylvania, November, 1936)

You have been engaged to make an audit of the Hardware Stores Company as of October 31, 1936. The trial balance of this company on that date is:

	Debits	Credits
Accounts payable		$ 23,000
Accounts receivable	$ 65,000	
Advertising	5,000	
Bad debts	2,000	
Bank discount	500	
Capital stock		50,000
Cash in bank	3,500	
Cash on hand	850	
Delivery equipment	1,230	
Discount on purchases		6,570
Dividends	15,000	
Electricity	1,500	
Freight, parcel post and express	1,900	
Heat	700	
Improvements	5,000	
Insurance	2,000	
Interest	250	

	Debits	Credits
Notes payable—bank		$ 10,000
Notes payable—trade		5,000
Office expense	$ 2,400	
Office furniture	1,500	
Petty cash	100	
Prepaid insurance	900	
Purchases	346,000	
Rent	6,000	
Reserve for depreciation on delivery equipment		380
Reserve for depreciation on office furniture		300
Reserve for depreciation on store fixtures		850
Sales		348,000
Store fixtures	2,500	
Surplus		59,630
Taxes	4,400	
Traveling expenses	1,500	
Wages	34,000	
Total	$503,730	$503,730

In the course of your audit you discover the following additional facts:

1. Advances to officers of $15,000 are included in the accounts receivable.
2. There is included in the accounts receivable $5,000 of accounts that are extremely doubtful of collection, of which $2,000 represents accounts of a period prior to November 1, 1935, which were doubtful of collection even on that date.
3. The bad debts charged off during the fiscal year ended October 31, 1936, represent accounts owed in previous years, which were doubtful of collection on November 1, 1935.
4. The insurance policies carried by the business are on an annual basis and are issued as of July 1 of each year.
5. The notes payable to banks represents a note discounted which will mature on November 30, 1936.
6. The notes payable to trade creditors represent the following notes, which bear interest at the rate of 6 per cent.

Dated	Maturity	Amount
October 16, 1936	November 15, 1936	$1,200
September 30, 1936	November 30, 1936	1,200
September 15, 1936	December 15, 1936	2,000
September 1, 1936	December 30, 1936	600

7. An analysis of the tax account reveals the following taxes that have been charged to this account:

a. Pennsylvania capital stock	$ 600
b. Federal capital stock	200
c. Federal income	3,600

8. An analysis of the wages account reveals the following distribution of wages:

	November 1, 1935, to December 31, 1935	January 1, 1936, to October 31, 1936
Department A	$ 750	$3,750
Department B	350	1,650
Department C	500	2,500
Delivery	400	2,100
Storeroom	700	3,800
Officers	1,500	8,500
Office	1,300	6,200

9. An analysis of the sales reveals the sales by each of the departments to be as follows:

Department A	$156,600
Department B	69,600
Department C	121,800

10. An analysis of the purchases account indicates that this account contains the inventory at the beginning of the year as well as the purchases during the year and that the amounts in respect to each department are:

	Inventory beginning of year	Purchases
Department A	$40,000	$121,500
Department B	15,000	54,000
Department C	21,000	94,500

11. You discover that no physical inventory has been taken. However, the records are maintained in a manner that will enable you to ascertain the inventory on the basis of the retail method. You learn that seasonal verification of the items in stock has been made. Your investigation of the records discloses the following additional information:

Departments	A	B	C
Inventory at beginning at retail	$ 50,000	$19,500	$ 28,200
Purchases during year at retail	153,375	71,200	127,000
Markdowns	1,500	1,000	1,200
Special allowances on contract sales	5,000	3,200	3,500

12. You discover that the store is leased for a period of ten years, from July 1, 1932, and that no amortization of the improvements made at the time of occupancy has ever been charged off. You also learn that the store fixtures will have no value if this lease cannot be renewed and that the office furniture has a remaining life of fifteen years. The delivery equipment was acquired in 1935, and the accrued depreciation to date is $580 including $200 for this year.
13. According to the plan of the building, the floor space occupied by the various departments is as follows:

Department A	40%
Department B	20%
Department C	25%
Storeroom	10%
Office	5%

Required:

1. The necessary closing journal entries and work sheet.
2. Calculation of inventories at the end of year.
3. Profit and loss statement for the year, including an analysis of departmental profits.
4. Analysis of the surplus account.
5. Calculation of state and federal income taxes.

Problem 23

(Wisconsin, November, 1937)

Attached hereto is a trial balance as of December 31, 1936, taken from the general ledger of the Wear-U-Well Shoe Manufacturing Company preparatory to closing the books for the year.

You are called in to make an audit of the year's transactions and make the necessary adjustments and closing entries to reflect correctly the income of the year 1936 and the balance-sheet as of December 31, 1936.

During the course of your audit of the accounts you ascertain the following:

1. An old leather-cutting machine which was purchased in 1928 for $2,590 was sold for $500 cash, and sales of leather findings was credited with the cash received.
2. Three new typewriters each costing $125 were purchased during the year and also one Burroughs electric calculating

machine for $375. These were discovered charged to supplies purchases but were found to be included in the closing inventory of finished goods at their cost prices.

3. The accounts receivable control account in the general ledger is $1,000 less than the sum total of the separate accounts in the detail ledger. Investigation shows that the bookkeeper failed to post a payment of $1,000 by the Brown Shoe Store to the detailed ledger account.
4. You find bond discount and expense appearing as an asset on the books ever since the bond issue was floated on July 1, 1933. These bonds are dated July 1, 1933, and carry interest at the rate of 5 per cent per annum, payable July 1 and January 1, and they all mature five years from date of issue.
5. Interest for the last six months has not as yet been paid on the bonds, and investigation failed to disclose any accrual thereof among any of the liabilities.
6. The following unpaid bills and invoices were found but not entered on the books. Investigation disclosed the fact that the services and other items were all received prior to taking the inventories.

December 26, 1936 Machinery repairs	$ 215.86
December 24, 1936 Purchase of sale stock	2,450.00
December 20, 1936 Water bill for quarter ended November 30, 1936—Discount date January 10, 1937	125.90
December 31, 1936 Traveling expense for president's trip to Boston, December 5, 1936	500.00

7. Analysis of the earned surplus account discloses the following credits and debits during 1936:

Credits:	
Refund of federal income tax for year 1930	$ 546.82
Overaccrual of real estate taxes for year 1935	92.48
Recovery of bad account charged off to surplus in 1934	121.96
Transfer from capital surplus account. Premium on capital stock issued in 1934	5,000.00
Debits:	
Reserve for inventory valuation	$ 15,000.00
Additional state income tax for year 1932	463.70
Officers' bonus for 1936	10,000.00
Dividend paid, December 15, 1936	100,000 00

8. Company occupies a leased building on a five-year lease effective July 1, 1932. Just prior to occupancy the company made extensive alterations in order to fit it to the company's use. These cost $10,000, all of which was charged to repairs when made.
9. Salesmen's advances represent money advanced them on future commissions. The account consists of the following:

James A. Pearson (discharged July 15, 1936)	$ 390.92
John Jones (presently employed)	542.60
R. B. Williams (presently employed)	250.72
William B. Farley (dismissed August 1, 1936)	414.72
Total	$1,598.96

10. Two new G.M.C. trucks were purchased during the year and were entered on the books at $1,325 each. The purchase contract discloses the following:

July 1, 1936		
2 new G.M.C. trucks—3 ton at	$1,500	$3,000
Deduct trade-in allowance:		
1928 model Dodge—2 ton	150	
1929 model Dodge—3 ton	200	350
Balance by cash received		$2,650

Investigation discloses that the two Dodge trucks had been written off in full against the depreciation reserve, it being the policy of the company to do this with all fully depreciated assets. The company has consistently used a 25 per cent rate on trucks.

11. The note at the bank was examined, and the following are the facts with respect thereto:

Date	November 1, 1936	Due	4 months
Interest rate	5 per cent	Face of note	$3,000

The bookkeeper explained that the bank deducted interest in advance and that the bank credited them with only $2,950.

12. Tax bills for real estate and personal-property taxes were found among the unpaid bills for 1937. The taxes represented the 1936 assessment due and payable on or before January 31, 1937.

These amounted to	$12,560.82

13. No depreciation has been taken on the books so far this year, it being the practice of the company to compute depreciation and enter it at the time of closing the books. They have followed a uniform practice of taking one-half year's depreciation on assets purchased or disposed of during the year. No changes in the assets accounts by way of additions or disposals occurred except those disclosed in these findings.

The depreciation rates are as follows:

Buildings—brick	2%
Buildings—frame	3%
Machinery and equipment	10%
Trucks	25%
Office furniture and fixtures	20%

14. The company pays its employees and officers on the tenth and twenty-fifth of each month. It is discovered that no accrual has ever been set up for the remaining days of December, on the theory that in the long run the expense would equalize itself. The payroll clerk was asked to compute the figures for the close of the past two years, which are as follows:

Wages and salaries for period:	
December 26–31, 1935, paid January 10, 1936.	$5,846.75
December 26–31, 1936, payable January 10, 1937	8,950.87

15. It is agreed that a reserve of 25 per cent of the adjusted net income (prior to income-tax reserves) be set up to take care of the state and federal income taxes on the current year's profits.
16. The inventory records show the following inventories (prior to adjustment) as of December 31, 1936:

Raw stock	$62,590.96
Goods in process	15,225.50
Finished goods	75,980.76
Automobile and truck supplies	600.00
Stationery and office supplies	850.00
Prepaid rent (6 months)	3,000.00
Prepaid insurance	628.40

A printed trial balance on standard work sheet form is submitted for your convenience. You are clearly to indicate and prepare on the work sheet:

1. Adjusting entries.
2. Closing entries.
3. Profit and loss statement for 1936.
4. Balance-sheet after closing.

Journal entries on separate sheets are not required.

WEAR-U-WELL SHOE MANUFACTURING COMPANY
Trial balance, December 31, 1936

	Debits	Credits
Petty cash	$ 1,000.00	
Cash in bank	20,982.75	
Accounts receivable	235,879.50	
Notes receivable (non-interest)	5,000.00	
Inventory—raw stock, December 31, 1935	50,797.77	
Inventory—goods in process, December 31, 1935	18,952.79	
Inventory—finished goods, December 31, 1935	80,462.75	
Inventory—automobile and truck supplies, December 31, 1935	1,500.00	
Raw stock purchases	582,606.70	
Supplies purchases	91,750.70	
Sales—shoes		$1,630,202.92
Sales—boots		72,720.90
Sales—leather findings		8,962.70
Prepaid insurance, December 31, 1935	582.70	
Prepaid rent, December 31, 1935	3,000.00	
Land	75,000.00	
Buildings—brick	120,000.00	
Buildings—frame	55,000.00	
Machinery and equipment	226,720.60	
Automobiles and trucks	2,650.00	
Office furniture and fixtures	2,500.00	
Reserve for depreciation—brick buildings		40,000.00
Reserve for depreciation—frame buildings		22,150.00
Reserve for depreciation—machinery and equipment		108,675.00
Reserve for depreciation—automobiles and trucks		
Reserve for depreciation—office furniture and fixtures		1,000.00
Stationery and office supplies inventory, December 31, 1935	875.00	
Bond discount and expense	10,000.00	
Capital stock outstanding		100,000.00
Surplus—earned		166,310.81
Surplus—capital		75,000.00

	Debits	Credits
Bonds payable—5% (interest dates January 1 to July 1)		$ 100,000.00
Accounts payable		78,962.70
Salesmen's advances	$ 1,598.96	
Notes payable—bank		2,950.00
Reserve for 2½ per cent privilege dividend tax		2,500.00
Reserve for inventory revaluation		15,000.00
Salaries and wages	680,000.00	
Rent paid	6,000.00	
Insurance	3,792.50	
Repairs	21,675.80	
Stationery and office supplies	3,762.00	
Bad debts written off	6,848.75	
Cash over and under	49.62	
Heat, light and water	9,767.92	
Telephone and telegraph	2,270.60	
Periodicals and trade journals	375.00	
Advertising	10,870.62	
Legal services	4,000.00	
Postage	1,980.00	
Shipping-department expense	22,670.90	
Traveling expenses	32,670.00	
Automobile and truck repairs	987.00	
Automobile and truck supplies	5,260.00	
Discount on sales	35,660.70	
Discount on purchases		15,679.91
Commissions earned		1,090.98
Recoveries on charged-off account		842.70
Interest paid	2,500.00	
Collection and exchange	375.60	
General expense	3,671.39	
Totals	$2,442,048.62	$2,442,048.62

Problem 24

(Wisconsin, November, 1936)

From the following trial balance and supplementary information, you are requested to make the necessary adjusting journal entries (without explanations) and to complete a work sheet in order to show the correct net profit or loss of the City Oil Company for the fiscal year ended June 30, 1936, and the balance-sheet after closing on June 30, 1936.

CITY OIL COMPANY
Trial balance, June 30, 1936

	Debits	Credits
Petty cash and change funds	$ 450.00	
Cash in bank	4,562.00	
Accounts receivable	22,465.00	
Notes receivable	4,300.00	
Cash surrender value of life insurance, June 30, 1935	3,266.00	
Gasoline and oil inventory, June 30, 1935	9,520.00	
Fuel oil inventory, June 30, 1935	1,370.00	
Specialties inventory, June 30, 1935	2,360.00	
Gasoline and oil purchases	163,400.00	
Fuel oil purchases	32,250.00	
Specialties purchases	4,940.00	
Gasoline and oil sales		$255,700.00
Fuel oil sales		48,025.00
Specialties sales		6,050.00
Accrued interest receivable, June 30, 1935	46.50	
Prepaid insurance	655.00	
Prepaid rent, June 30, 1935	500.00	
Land	54,000.00	
Buildings on owned land	50,550.00	
Buildings on leased land	8,400.00	
Automobiles and trucks	8,740.00	
Station and office equipment	33,049.50	
Reserve for depreciation—buildings on owned land		11,474.00
Reserve for depreciation—buildings on leased land		1,182.78
Reserve for depreciation—automobiles and trucks		4,275.00
Reserve for depreciation—station and office equipment		10,935.00
Reserve for estimated depreciation for year 1935–1936		7,500.00
Treasury stock		1,200.00
Office and station supplies inventory, June 30, 1935	825.00	
Notes payable		7,000.00
Accounts payable		4,521.60
Accrued interest payable, June 30, 1935		652.00
Accrued salaries and wages		1,142.00
Accrued taxes		5,326.00
Land contract payable		2,400.00
Bonds payable		40,000.00
Common stock—$10 par value		90,000.00
Preferred stock—$100 par value		10,000.00

	Debits	Credits
Earned surplus, June 30, 1935		$ 10,371.66
Profit and loss	$ 472.00	
Salaries and wages	21,025.00	
Taxes	52,322.04	
Depreciation	7,500.00	
Gasoline inspection	570.00	
Unemployment insurance	401.00	
Life insurance	400.00	
Other insurance	1,460.00	
Repairs and maintenance	2,575.00	
Office supplies and postage	570.00	
Heat, light and water	2,950.00	
Telephone and telegraph	675.00	
Station supplies	1,060.00	
Advertising	1,540.00	
Donations	425.00	
Professional services	520.00	
Dues and subscriptions	375 00	
Rent	10,650.00	
Bad debts	846.00	
Recoveries on bad debts		130.00
Interest received		250 00
General expense	2,950.00	
Interest expense	3,200.00	
Totals	$518,135.04	$518,135.04

NOTATIONS

1. Total of accounts receivable per the detail ledger was $22,395 as of June 30, 1936, which is considered to be correct.
2. A note receivable, without interest, of $1,000 was received in settlement of a customer's account on May 1, 1936. The company borrowed $1,000 from the bank the same day at 6 per cent interest with the customer's note as collateral and credited the $1,000 to customer's open account. On June 1 the customer made a payment of $200 on his note direct to the bank which applied the payment to the company's note. None of the above facts except as stated has been recorded on the company's books, and no interest has been paid to the bank.
3. Cash surrender value of life insurance on June 30, 1936, is $3,375

4. Inventories were as follows:

	June 30, 1936	June 30, 1935
Gasoline and oil	$8,800	$9,520
Fuel oil	1,070	1,370
Specialties	2,710	2,360
Office supplies	460	400
Station supplies	480	425

It was also learned that an error had been made on June 30, 1935, in measuring one of the gasoline tanks at the bulk plant and that the actual gasoline inventory of that date had been overstated by $500.

5. Interest should be accrued on the following receivables and payables shown in the trial balance:

	Principal	Interest rate	Interest paid to
Note receivable	$ 1,200	6%	April 30, 1936
Note receivable	1,200	5%	March 31, 1936
Note receivable	1,900	6%	May 31, 1936
Total	$ 4,300		
Note payable	$ 7,000	6%	May 15, 1936
Bonds payable	$40,000	5%	March 31, 1936

6. All rentals payable during the past year were paid during the months for which the rents were due excepting those covered by the following leases of properties on which the company had constructed filling stations as indicated. Corrections should be made as necessary for both the opening and the closing prepaid and accrued rent balances. All rental payments on these leases were made when due.

Leases:

a. Term June 1, 1934, to May 31, 1949, at $900 annual rental payable annually in advance. Company constructed building on property June 1, 1934, costing $5,000.

b. Term February 1, 1933, to January 31, 1943, at $750 annual rental payable every three months in advance. Company constructed building on property February 1, 1933, costing $3,400.

c. Term March 1, 1934, to February 28, 1940, at $600 rental first year, $750 rental second year and $900 annually thereafter. Rent payable every three months in advance.

7. The following unpaid bills have not been entered on the books:
   a. Bill of $150 for fuel bought in March, 1936—not entered because it was agreed that it would be offset against an account receivable from the Fuel Company which on June 30, 1936, had reached a balance of only $85.
   b. Bill of $500 for new station equipment bought in March, 1936, being paid for in five equal instalments. The first three instalments had been paid prior to June 30, 1936, and the payments were charged to station and office equipment.
8. Depreciation has always been calculated at the rates shown below with a half-year's amount on all current-year additions. The half-year provision does not apply, however, to buildings on leased land. These buildings are written off over the terms of the respective leases.

	Asset balance July 1, 1935	Additions 1935–1936	Credits to asset account 1935–1936	Asset balance June 30, 1936	Depreciation rate
Buildings on owned land	$45,550.00	$5,000.00		$50,550.00	5%
Buildings on leased land	8,400.00			8,400.00	
Automobiles and trucks	7,800.00	1,140.00	$200 00	8,740.00	20%
Station and office equipment	31,149 50	2,000.00	100.00	33,049.50	10%

A truck costing $900 in 1933–1934 was traded in 1935–1936 for a new adding machine costing $320 plus cash of $200. The only entry made was the cash receipt of $200 which was credited to automobiles and trucks.

A building on owned land costing $3,000 in 1926–1927 and an addition thereto constructed in 1928–1929 at a cost of $500 were torn down during 1935–1936. The contractor who tore down the building took the salvage materials as his pay. No entries have been made on the books.

A bookkeeping machine costing $800 in 1930–1931 was sold in 1935–1936 for $100. Credit of this $100 to station and office equipment was the only entry made.

Monthly entries made to record estimated depreciation during the year are reflected in the trial balance.

9. Two years ago 800 shares of common stock were purchased at par as treasury stock. These 800 shares were sold during 1935–1936 at $11.50 per share. The proceeds were credited to treasury stock.
10. A land contract payable of $2,700 was given by the company on March 31, 1936. Payments of $100 each were made by the company on April 30, 1936, May 31, 1936, and June 30, 1936, and charged against the liability account. The contract provides that 6 per cent interest on the unpaid balance of principal is to be calculated on each monthly payment, the remaining amount to be applied to reduce the principal.
11. Analysis of accrued taxes account for 1935–1936 per books is as follows:

		Debits	Credits
Balance, July 1, 1935:			
Estimated property taxes for first six months of calendar year	$1,500		
Capital stock tax due July, 1935	200		
Federal income tax for 1934–1935	860		
State income tax for 1934–1935	325		
Gasoline tax for June, 1935, payable in July, 1935	3,852		
Total balance, July 1, 1935	....		$6,737
Payments charged here during 1935–1936:			
Federal income tax 1934–1935—part payment		$215	
State income tax, 1934–1935		325	
Capital stock tax due July 1935		200	
Federal income tax, 1934–1935—part payment		215	
Federal income tax, 1934–1935—part payment		215	
State income tax—additional for year 1933–1934 as result of audit by State Tax Commission		241	

Analysis of taxes expense account for 1935–1936 per books is as follows:

Gasoline taxes—12 monthly payments made during fiscal year	$48,961.84
Property taxes for 1935 paid February, 1936	2,945.20
Federal income tax, 1934–1935—part payment	215.00
Advance payment on property taxes for 1936 payable in February, 1937	200.00
Total per trial balance	$52,322.04

In adjusting taxes and accrued taxes consider also:

a. Capital stock tax payable in July, 1936, on declared value as of June 30, 1936, is $150.

b. Unpaid gasoline tax for June, 1936, is $4,125. Gasoline taxes are payable monthly.

c. Property taxes for the calendar year 1936 are to be estimated at $3,000, i.e., $1,500 for the first six months of the year.

12. Profit and loss balance of $472 represents an unpaid expense bill of June, 1935, not set up as an account payable on June 30, 1935, but paid in August, 1935.

SECTION II

ANALYSIS OF STATEMENTS

Problem 25

(New York, May, 1935)

A client sends you thc following statements of the X Y Z Company and advises that he has been offered a block of stock at 90, which is the same price at which 3,000 shares, par value $100, were issued during 1934.

Prepare for submission to the client an analysis of working-capital changes and any other information relative to ratios, turn-overs and relationships that you think pertinent and can extract from the statements.

Comparative balance-sheet

Assets	January 1, 1934	December 31, 1934
Goodwill	$ 200,000	$ 230,000
Land and buildings	450,000	750,000
Machinery	200,000	400,000
Tools	40,000	80,000
Unexpired insurance	3,000	4,000
Inventories	400,000	375,000
Accounts receivable	175,000	250,000
Cash	25,000	20,000
Investments in bonds	95,000	
Totals	$1,588,000	$2,109,000
Liabilities and capital		
Capital stock	$ 800,000	$1,100,000
Bonds	350,000	500,000
Bank loans	70,000	80,000
Accounts payable	145,000	125,000
Accrued interest	7,000	11,000
Accrued taxes	4,000	6,000
Surplus	212,000	287,000
Totals	$1,588,000	$2,109,000

Condensed statement of profit and loss, 1934

Sales	$2,140,000
Cost of goods sold (including depreciation below)	1,550,000
Gross profit	$ 590,000
Selling expenses	171,200
Trading profit	$ 418,800
Operating expenses	278,200
Operating profit	$ 140,600
Other expenses	33,600
Net profit for year	$ 107,000
Surplus, January 1, 1934	212,000
Total	$ 319,000
Dividends paid in cash	32,000
Surplus, December 31, 1934	$ 287,000

Depreciation on buildings	$ 7,000
Depreciation on machinery	16,000
Depreciation on tools	4,000
Total	$ 27,000

Problem 26

(American Institute of Accountants, November, 1937)

You have been handed a circular letter received by a common stockholder of a company wherein the income from operations of the company for the past year is shown as materially greater than for the year before. The only information given is as follows:

> For the year 1936 the gross income of the company was $4,700,000, and after deducting $4,000,000 for cost of goods sold, general, selling and administrative expenses, and $250,000 for depreciation, interest and federal income taxes, the net profit was stated to be $450,000, which was equivalent to 24 cents per share on the outstanding common stock, after paying the 6% dividend on preferred stock.
>
> The net income for 1935 was $196,000 which was equal to 2 cents per share on the outstanding common stock after paying the preferred dividend.
>
> The stockholder recalls that the only stock changes during the two years were issues on January 1, 1936, of 200,000 shares common, and of $500,000 preferred.

In view of the large difference in the stated profit per share from that of the previous year, you are asked to advise if the reported result appears reasonable.

Prepare a statement for the stockholder explaining and reconciling the figures of the two years, showing number of shares of common stock and amount of preferred stock outstanding.

Problem 27

(American Institute of Accountants, May, 1937)

A corporation, engaged in manufacturing and wholesaling two principal products, has called upon you for advice on their sales policy for the coming year.

In prior years selling expenses were 18% of the sales, of which one-third was for advertising. Administrative expenses were 5% of the sales.

Two propositions are now under consideration by the management by either of which they hope (1) to increase the volume of sales, (2) to decrease unit production costs, and (3) to reduce relative selling expenses. These propositions are outlined to you by the management as follows:

Proposition 1. Premium Stamp Books

Premium stamp books will be widely distributed to consumers who will obtain stamps from the packaged products. When a book is filled with stamps (100 stamps to each book) it may be returned to the corporation and will be redeemed by the award of a prize or premium described under the unbroken seal attached to the book and intact at the time of presentation. A schedule of such prizes and premiums which the management proposes in this plan is as follows:

Number of books	Prize each	Amount
1	$150.00	$ 150
5	50.00	250
14	20.00	280
50	10.00	500
160	5.00	800
1,020	1.00	1,020
8,750	0.40	3,500
10,000		$6,500

Every 10,000 books distributed will provide for prizes in accordance with the above schedule. This is *definitely fixed and not subject to alteration or modification.*

The cost of this plan will be as follows:

Books, including expense of distribution..	$ 15	per M books
Stamps..............................	1	" M stamps
Prizes, according to schedule...........	650	" M books

It is proposed that each package of product A shall contain 8 premium stamps and each package of product B 4 premium stamps. The premium stamp book plan is intended to take the place of all previous advertising which will be immediately discontinued if this proposition is adopted. Selling prices previously established will be maintained without change.

Proposition 2. REDUCED SELLING PRICES

Under this plan it is proposed to reduce selling prices of product A by 8⅓% and of product B by 5% and to continue all previous advertising with some increase therein. This proposition is being considered as an alternative of proposition 1, and if adopted no use will be made of premium stamp books.

	Product A	Product B
Facts as to previous operations.		
Average quantity sold per annum.........	200,000 units	600,000 units
Production costs, per unit...........	40¢	30¢
Selling prices, per unit..................	60¢	40¢
Expected changes:		
Increase in unit sales volume		
Proposition 1.......................	50%	50%
" 2.......................	40%	25%
Decrease in unit production costs		
Proposition 1.......................	5%	10%
" 2.......................	7½%	6⅔%
Advertising		
Proposition 1.......................	None	None
" 2.......................	8% of sales	7% of sales
Other selling expenses		
Proposition 1.......................	15% of sales	12% of sales
" 2.......................	12% " "	12% " "
Premium book expenses		
Proposition 1.......................	(As indicated)	
" 2.......................	None	None
Administrative expenses		
Proposition 1.......................	4% of sales	4% of sales
" 2.	Same amount as in prior years.	

It is requested that you make any definite recommendation for modifying either proposition that will further advance the management's objects.

In proposition 1 it is assumed that premium stamp books and stamps will be distributed in exactly sufficient quantities to supply every customer under the proposed schedule of sales and that all such books and stamps will be redeemed.

Prepare a schedule, such as you would submit to the management, giving a comparison of the operations in previous years with those under both propositions as originally made or as modified by you, accompanied by statistical data and analysis. Arrange the schedule so that it will permit an easy appraisal of the advantages and disadvantages of the proposals and show whether or not the desired results in respect of increased sales, decreased cost and decreased selling expenses are attained. Your conclusions must be apparent from the comparisons submitted.

Problem 28

(American Institute of Accountants, May, 1936)

The members of a medical society are classified according to the number of years each one has been in practice. They pay admission fees and annual dues as follows:

Class	Years in practice	Admission fees	Annual dues
A	Over 25	$150	$100
B	10–25	75	50
C	Under 10	None	25

Dues are payable for the entire year, irrespective of the date on which membership becomes effective.

No refunds are made on account of resignations, expulsions, etc.

Members reinstated are required to pay a full year's dues as of the date of reinstatement but no admission fees.

Transfers to higher classes become effective as of the beginning of the year and involve no admission fees.

During the years 1933, 1934 and 1935 the following changes took place in the membership:

	1933			1934			1935		
	A	B	C	A	B	C	A	B	C
Balance at beginning of year..	150	275	120	152	285	130	147	304	158
Add:									
Elections....	5	14	39	2	12	63	3	7	138
Reinstatements	2	3	1	1	2	2		1	1
Transfers (per contra).......	17	23		10	31		14	19	
Total additions.....	24	40	40	13	45	65	17	27	139
Totals................ ..	174	315	160	165	330	195	164	331	297
Deduct:									
Deaths....................	9	3	2	13	2	1	11	5	2
Resignations...............	10	5	2	3	11	4	4	10	5
Expulsions.................	3	5	3	2	3	1	1	5	1
Transfers (per contra).......		17	23		10	31		14	19
Total deductions... . ..	22	30	30	18	26	37	16	34	27
Balance at end of year..	152	285	130	147	304	158	148	297	270
Totals, A, B, and C.. . ..		567			609			715	

In the three years the expenses respectively amounted to \$39,621, \$41,236 and \$44,787. There are no outside sources of revenue.

Although the membership is increasing, the society finds it more and more difficult to balance its budget, and it is proposed to remedy this condition and provide the funds for increased activity by making the following changes in the members' fees and dues, viz.:

1. Class C members to pay \$25 admission fees.
2. Class C members to pay \$50 when they become class B members.
3. Class B members to pay \$75 when they become class A members.
4. Class C dues to be increased to \$40 and class B dues to \$75 per annum.

From the foregoing data prepare:

(a) A statement showing income and expenses for each of the years 1933, 1934 and 1935.

(b) A statement of income and expenses for 1935 as they would have been if the proposed increases in fees and dues had become effective at the beginning of that year. It is understood that the increases had had no effect upon the changes in membership.

Problem 29

(American Institute of Accountants, May, 1934)

Charles Black & Co., a corporation, had a factory whose output was absorbed by two customers.

The president and the treasurer each signed cheques, only one signature being necessary. The president bought the raw materials and supplies. The treasurer kept the books, handled the receipts and drew the cheques. Incidentally, he was also receiving teller in one of the local banks patronized by the company.

The accounts of Charles Black & Co. had never been audited until the president demanded an audit which developed at once into an investigation.

All the paid cheques returned by the banks were on hand and available to the auditor, and the cheques received from the two customers were produced on request. After a brief examination of the latter inquiries revealed that the treasurer had a personal account in his own bank and another in a large bank in an adjacent city.

It was found that $65,000 of customers' cheques had not been credited to them nor entered anywhere on the books (except $10,000 mentioned below). The treasurer had endorsed the cheques for the company in blank in his own handwriting and used them himself by passing them through bank accounts other than those of the company, as evidenced by later endorsements.

There were cheques aggregating $25,000, which had been credited to customers' ledger accounts but not entered in the cashbook nor deposited in the company's bank account. These were similarly endorsed and used.

Cash sales of old machinery and scrap amounting to $1,200 had been made and entered, but the proceeds were retained by the treasurer.

A mortgage was placed on the factory for $10,000 and the company received the money in two instalments of $5,000 each. The full amount was entered in the cashbook as received and credited to mortgage account in the ledger, but only $5,000 was placed in the bank. The other $5,000 was taken by the treasurer, for which he gave his note. An entry crediting cash and charg-

ing notes receivable was made by him. Several months later he discounted at the bank a company note for $5,000 to the credit of the company, charging cash as if coming from him and crediting notes receivable. He destroyed his own note. When the company's note was due the bank charged it to the company, but no entry whatsoever was made on the books. The treasurer destroyed this note also. The president of the company knew of the mortgage but denied all knowledge of the notes.

Later another $10,000 was borrowed on the mortgage, but no entry was made on the books. The treasurer turned this money to his own uses. About a month later one customer's cheque for $10,000, as above mentioned, was credited to the [illegible] account instead of being credited to the customer.

On the other hand, $30,000 in all was deposited in the bank at various dates to the credit of the company by the treasurer himself, without entry on the books.

Payments to creditors and for salaries and wages and other expenses for the past year, by quarters, aggregated as follows:

	Per cash book	Per cheque book stub	Per cheques
Accounts payable—1st quarter	$ 3,225	$ 2,525	$ 1,725
" " 2nd "	3,000	2,500	2,000
" " 3rd "	8,250	7,250	6,250
" " 4th "	4,800	4,300	3,500
Totals	$19,275		$13,475
Cash for salaries, wages, etc.:			
" " " 1st quarter	3,100	3,500	4,100
" " " 2nd "	5,600	5,600	6,600
" " " 3rd "	1,500	2,000	2,500
" " " 4th "	2,700	4,500	5,500
Totals	$32,175	$32,175	$32,175

All correspondence from creditors relative to short payments had been suppressed by the treasurer.

If the candidate finds any evidence of shortage in the figures next above he may consider them part of the defalcation.

Prepare a statement showing briefly the several items making up the total defalcation. Disregard interest. No journal entries are wanted.

Problem 30

(American Institute of Accountants, November, 1932)

You are engaged by a certain professional association, founded January 1, 1929, to audit the books of account and records for the period of one year and six months ended June 30, 1931. The purpose of this organization is to promote the welfare of the profession. To this end it engages in various activities, principally the publication of monthly bulletins containing data of interest to its members. These bulletins are printed by outside printers and are mailed each month to the membership. At the end of the year, additional bound volumes of the twelve issues are available to the members for $8.60 a volume. Extra copies of the monthly bulletin are sold at 50 cents each.

The membership dues are $10 per annum, payable in advance, and it is customary to charge the members with the full year's dues on January 1st. All dues for 1931 are paid.

A trial balance of the books as at June 30, 1931, before audit adjustments, was as follows:

Cash in bank	$ 5,300	
Accounts receivable—members	11,250	
" " —advertising	625	
Inventory of publications—December 31, 1930	20,800	
Accrued interest receivable	200	
Stocks and bonds	15,000	
Furniture and fixtures	5,400	
Prepaid insurance	70	
Accounts payable		$ 2,700
Reserve for depreciation		1,250
Surplus		37,748
Membership dues—1931		32,500
" " —1932		1,500
Sales of bulletins		4,442
" " advertising matter		3,250
Interest on investments		300
Salaries	10,000	
Printing bulletins	11,420	
Office expense	2,455	
Depreciation	270	
Binding	900	
Totals	$83,690	$83,690

The profit-and-loss account for the year ended December 31, 1930, as disclosed by items in the surplus account on the books, was as follows:

	1930
Membership dues—1930	$38,000
" " —1931	400
Sales of bulletins	9,840
" " advertising matter	4,450
Interest on investments	700
Total	$53,390
Opening inventory	17,600
Binding bulletins	900
Printing bulletins	22,940
Total	$41,440
Closing inventory	20,800
Remainder	$20,640
Salaries	17,700
Office expense	2,600
Depreciation	525
Total	$41,465
Net profit to surplus	$11,925

Inventories of publications (by quantities) on hand, at closing dates, were as follows:

	Bound sets	Unbound sets	Single bulletins
June 30, 1931:			
1931			11,000
1930	250	700	1,500
1929	1,380	1,100	3,500
December 31, 1930:			
1930	300	700	2,000
1929	1,500	1,100	3,700
December 31, 1929:			
1929	1,900	1,100	4,100

The cost of printing is 30 cents a bulletin, and the cost of binding $3 a volume. During the period under review, 6,000 copies of each month's bulletin were printed.

The liabilities as at June 30, 1931, are all shown on the books.

It is agreed that the bound and unbound bulletins for the year 1929 are to be written down to one-half on December 31, 1930; and on June 30, 1931, to one-quarter of their cost. The bulletins

for 1930 are to be written down to three-quarters of their cost on June 30, 1931.

You are required to prepare the following statements:

(a) Balance-sheet as at June 30, 1931.
(b) Income statements for the year 1930 and for the six months ended June 30, 1931.
(c) Statement showing opening and closing inventories, purchases, distribution and sales of bulletins for each period. Show quantities and amounts.

Submit your working papers.

SECTION III

STATEMENT OF FUNDS—SOURCES AND APPLICATION

Problem 31

(District of Columbia, November, 1936)

From the following information prepare a statement of application of funds of A, B and C for the year ending June 30, 1936:

A, B AND C (A PARTNERSHIP)
Preclosing trial balances, June 30, 1935 and 1936

	June 30, 1935	June 30, 1936
Debits		
Inventory at beginning of year	$ 17,384 67	$ 24,865.59
Repossessed merchandise	2,115.36	6,544.56
Instalment receivables	26,265.41	30,598.03
Cash	32,001.04	23,000.87
Investments	10,727 62	8,399.73
Office equipment	8,447 00	9,457.00
Reserve for depreciation	2,347.00*	3,072.00*
Goodwill	5,000.00	6,500.00
Purchases for year	68,322 53	64,123.43
Expenses	15,552.94	28,329.61
Partners' withdrawals	22,500.00	25,000.00
Total debits	$205,969 57	$223,746.82
Credits		
Sales	$122,507.25	$120,359.38
Profit on investment sold		3,251.00
Service charges	6,962.32	7,386.44
Notes payable, long-term	14,500.00	42,750.00
A	20,000.00	25,000.00
B	30,000.00	25,000.00
C	12,000.00	
Total credits	$205,969.57	$223,746.82

* Red.

The inventory at June 30, 1936, was $28,357.52. Repossessed merchandise account, unadjusted for years, has been charged with balances of instalment accounts covering items recovered and is credited with sales; the balances at the beginning and end

of the year ending June 30, 1936, on the basis of resalable merchandise should have been $1,105.86 and $5,242.57, respectively.

Instalment receivables have an average life of nine months. The service charges are credited to income when the accounts are booked.

Certain long-term investment securities were sold during the year; none was purchased. Sales of office equipment, amounting to $435, were credited directly to the asset account, and the balance, $920, of the original cost was charged to depreciation reserve. Partners' withdrawals include regular salaries of $15,000, the balance being regarded as withdrawals of profits.

Notes payable retired during the year amounted to $10,000.

Expenses for the year include the goodwill account at the beginning of the year. The goodwill account now on the books represents the amount paid in cash to retiring partner C over and above his investment. Book profits remaining at the end of each year are distributed in cash on July 15. During the year, A paid B $5,000 in cash in order to equalize their investment accounts.

Problem 32

(New York, June, 1932)

Prepare a statement of application of funds for the Blank Manufacturing Company from the following information:

	December 31	
Assets	1931	1930
Goodwill		$ 200,000
Land	$ 140,000	150,000
Buildings	610,000	360,000
Machinery	330,000	200,000
Tools	40,000	70,000
Bond investments	18,000	15,000
Inventories	210,000	218,000
Accounts receivable	180,000	92,000
Notes receivable	21,000	27,000
Cash in bank		8,000
Cash in hand	2,000	1,000
Unexpired insurance	1,200	1,400
Deferred bond discount	2,100	2,500
Totals	$1,554,300	$1,344,900

Liabilities	December 31 1931	1930
Capital stock	$ 500,000	$ 200,000
Mortgage payable	150,000	100,000
Accounts payable	58,000	52,000
Bank overdraft	4,000	
Notes payable, trade	9,000	10,000
Bank loans	5,500	6,800
Accrued interest	10,000	6,000
Accrued taxes	5,000	3,000
Reserve for bad debts	4,500	2,300
Reserve for depreciation of plant	271,200	181,000
Surplus	537,100	783,800
Totals	$1,554,300	$1,344,900

During the year 1931 the following changes took place:

1. A 4 per cent dividend was declared and paid, this on the outstanding capital stock of January 1, 1931.
2. Depreciation was provided as follows:

Buildings	$60,690
Machinery	32,810
Tools	30,000

3. Stock was sold during the year at 90, the difference being sent to goodwill account.
4. Goodwill was written off during the year.
5. Old equipment which cost $4,500 was scrapped and written off the books. Accrued depreciation on such equipment to date was $3,300. Adjustment was made to surplus account.
6. Land account was written down against surplus account.
7. Net loss for the year 1931 of $27,500 was sent to surplus account.

Surplus account contains no adjustments other than as above indicated. Prepaid expenses are to be considered as current assets.

Problem 33

(American Institute of Accountants, November, 1936)

The balance-sheets of the Anonymous Manufacturing Company at the beginning and the end of the year are shown below:

Assets	January 1	December 31
Current assets:		
Cash	$ 7,928.15	$ 4,720.68
Accounts receivable	11,926.28	14,030.00
Inventories	107,434.69	128,749.71
Total current assets	$127,289.12	$147,500.39
Advances to employees		201.61
Permanent investments	10,053.63	9,700.00
Plant and equipment, less depreciation	131,900.08	133,124.89
Deferred charges	2,181.48	2,310 88
Totals	$271,424.31	$292,837.77
Liabilities		
Current liabilities:		
Notes payable to bank	$ 14,000.00	$ 30,000.00
Trade accounts payable	3,425.29	4,366.91
Accrued expenses—payrolls, etc	2,166.48	2,445.20
Federal income tax payable	2,503.33	2,874.55
Total current liabilities	$ 22,095.10	$ 39,686.66
Mortgage bonds	50,000.00	41,000.00
Capital stock	100,000.00	100,000.00
Surplus	99,329.21	112,151.11
Totals	$271,424.31	$292,837.77

Also the following information is procured:

The net profit for the year, before deducting federal income tax, was $20,709.58.

The federal income tax for the year amounted to $2,874.55.

Surplus was charged with $13.13 for additional federal income tax for a prior year.

Depreciation expense for the year amounted to $8,659.24.

The company lost its entire investment in the Everywhere Export Corporation, namely 35 shares which originally had cost $353.63.

The company sold an automobile for $110, which had been bought for $677.75 and had been depreciated $519.61 at the time of sale.

Purchases of machinery and equipment during the year amounted to $9,267.37.

Other purchases were an automobile for $641.32 and other equipment $133.50.

A dividend of $5,000 was declared and paid during the year.

Prepare (a) a statement showing the items that contributed to the increases and decreases of the company's working capital and (b) a statement showing the "application of funds."

Also state (c) how the two statements compare in general usefulness to the client.

Problem 34

(District of Columbia, May, 1932)

From the following information prepare a statement showing the sources from which funds were derived and the manner in which they were disposed of during the year 1931:

MONO PRINTING COMPANY
Trial balances, December 31, 1930 and 1931

Account	December 31 1930	December 31 1931
Cash in bank	$ 10,270.08	$ 17,344.40
Cash on hand	500.00	1,000.00
Sinking-fund trustee	2,816.25	6,041.67
Trade receivables	307,313.09	210,786.55
Inventories	115,504.53	78,555.18
Prepaid insurance and supplies	6,205.99	4,327.14
Notes receivable from officers	26,252.49	19,711.42
Cash surrender value of life insurance policies	13,417.52	10,815.30
Deferred bond expense	3,995.51	2,904.69
Land, buildings, machinery and fixtures	723,330.06	733,683 83
Investments	51,269 70	66,420 37
Total debits	$1,260,875.22	$1,151,590.55
Trade payables	$ 51,623.87	$ 42,098.32
Accrued taxes and wages	39,267.40	28,764.81
Notes payable on purchases of machinery	65,896 02	
Accrued interest on machinery notes	689.90	
6 per cent first-mortgage bonds	180,000 00	170,000.00
Accrued interest on first-mortgage bonds	1,350.00	1,275.00
Reserve for bad debts	24,930 20	18,447.08
Reserves for depreciation	147,982.66	172,224 97
Common stock	600,000.00	650,000 00
Surplus	149,135.17	68,780.37
Total credits	$1,260,875.22	$1,151,590.55

The value of land, buildings, machinery and fixtures was increased by purchases of new equipment totaling $25,149.08; at the same time, old equipment costing $14,795.31, upon which there was accrued depreciation of $10,040.69, was sold for $2,575. Depreciation charged to expense during 1931 amounted to $34,283

Following is an analysis of investments:

Kind	Acquired	Cost	Selling price	On hand at December 31, 1931
500 shares Center Paper Company stock (¼ of total capitalization)	April 3, 1928	$50,000.00		$50,000 00
Public utility bonds	November 20, 1930	1,269 70	$ 1,275 00	
Public utility bonds	June 10, 1931	10,425 00	10,650 00	
Public utility bonds	September 22, 1931	5,000 00	5,050.00	
Public utility bonds	December 25, 1931	16,420.37		16,420.37
Totals		$83,115 07	$16,975 00	$66,420.37

Bonds represented a temporary investment of surplus cash.

Of the machinery notes unpaid on December 31, 1930, $37,902.40 were due in 1932 and subsequent years; all machinery notes were liquidated by the payment of $50,000 in capital stock and the balance in cash.

Mortgage bonds totaling $25,000 mature on May 15, 1932, and a similar amount on November 15, 1932.

Following is an analysis of the sinking-fund trustee account:

Cash:		
Balance, January 1, 1931	$ 2,816 25	
Receipts:		
Cash deposited for payment of principal and interest	23,933 34	
Proceeds from sale of securities	17,325 00	
Interest received	623.02	$44,697.61
Disbursements:		
Purchase of securities	$22,200.00	
Accrued interest purchased	224.99	
Bonds redeemed	10,000 00	
Bond interest paid	10,650.00	
Trustee's fees and expenses	405.95	43,480.94
Balance, December 31, 1931		$ 1,216.67

Securities:

Kind	Cost	Selling price	On hand at December 31, 1931
Real estate bonds	$ 7,500.00	$ 7,500.00	
Railroad bonds	9,875.00	9,825.00	
Utility bonds	4,825 00		$ 4,825.00
Totals	$22,200.00	$17,325.00	$ 4,825.00
Total cash and securities			$ 6,041.67

Prepaid expenses are to be treated as current assets.

The reduction of officers' notes receivable represents the payment of the note of a retiring officer.

Cash surrender value of life insurance policies was increased by $7,397.78 and decreased by a loan on the policies of $10,000.

Deferred bond expense was decreased by the annual write-off provided for in an amortization schedule.

Operating losses for 1931 amounted to $80,354.80, after deducting a refund received on 1929 federal income tax of $4,157.20 and accrued interest thereon of $244.23.

Problem 35

(American Institute of Accountants, May, 1933)

You are engaged by the chairman of the reorganization committee of the S Y Manufacturing Company to make an examination of the books of account and records of the company for the period from January 1, 1926, to June 30, 1932, and to render a report. It is specifically requested by the chairman that your report contain an application-of-funds statement embodying a complete summary of securities and cash transactions during the period.

Your examination discloses the following facts:

The company was organized January 1, 1926, to bring together, under the control of one corporate management, five competing concerns manufacturing automobile accessories, with plants located in distant large cities.

The new corporation took over the fixed assets of all the other companies (gross value $8,000,000 less $3,000,000 depreciation), issuing cash and securities therefor, as set forth in the following summary:

Name of plant	Cash and securities issued for net assets acquired: First mortgage 6% gold bonds at par	7% preferred stock at par	No-par common stock at stated value	Cash	Totals
A	$ 800,000			$ 200,000	$1,000,000
B		$300,000		500,000	800,000
C	800,000		$ 400,000		1,200,000
D				400,000	400,000
E			1,600,000		1,600,000
Totals	$1,600,000	$300,000	$2,000,000	$1,100,000	$5,000,000

Particulars	1926	1927	1928	1929	1930	1931	Six months ended June 30, 1932	Totals
Net profits transferred to surplus	$400,000	$300,000	$700,000	$ 948,000	$238,000	$700,000*	$600,000*	$1,286,000
Surplus credits—profits on bonds retired	...	...	...	2,000	12,000	50,000	...	64,000
Dividends declared—								
Preferred	70,000	70,000	105,000	140,000	140,000	140,000	...	665,000
Common	225,000	225,000	450,000	610,000	450,000	...	...	1,960,000
Additions to property (net)	200,000	400,000	500,000	1,000,000	400,000	100,000	25,000	2,625,000
Provisions for depreciation	330,000	350,000	370,000	420,000	480,000	505,000	255,000	2,710,000
Book value of property retired, charged to depreciation reserve	350,000	300,000	250,000	700,000	300,000	300,000	125,000	2,325,000
Expenditures for renewals, charged to depreciation reserve	...	...	...	30,000	20,000	...	...	50,000
Salvage recoveries, credited to depreciation reserve	10,000	20,000	5,000	25,000	15,000	10,000	...	85,000
Bonds retired through sinking fund (a)—								
Principal amount	...	...	100,000	100,000	100,000	100,000	...	400,000
Cost	...	...	100,000	98,000	88,000	50,000	...	336,000
Sales of securities carried as permanent investments (b)—								
Book value	...	...	...	200,000	500,000	300,000	...	1,000,000
Losses charged to profit-and-loss account	...	...	...	100,000	300,000	200,000	...	600,000

* Denotes red figures.

(a) Sinking-fund requirement first effective for the year 1928 and company defaulted on 1932 requirement.

(b) Acquired from predecessor companies at date of organization of corporation.

In order to provide cash for working capital and to pay off bank loans of $1,000,000, releasing collateral set up at a like book value, additional securities were issued as follows:

$900,000 first mortgage 6 per cent gold bonds at 90
$700,000 7 per cent preferred stock at par
100,000 shares, no-par common stock, at $15 per share.

The capitalization of the new company was as follows:

First mortgage 6 per cent sinking fund gold bonds	$2,500,000
7 per cent preferred stock, par value $100 per share	$2,500,000
No-par common stock, stated value $10 per share	350,000 shares.

Further information, obtained in the course of your examination, is set forth in the tabulation on page 79.

As of January 1, 1928, the corporation issued and sold 5,000 shares of its 7 per cent preferred stock at par. As of January 1, 1929, it issued and sold 5,000 shares of its 7 per cent preferred stock at par and 5,000 shares of its no-par common stock at $25 per share, in order to provide additional working capital and for other corporate purposes.

Upon the basis of your examination of the company's accounts, you have prepared the following balance-sheet as of June 30, 1932:

THE S Y MANUFACTURING COMPANY
Balance-sheet, June 30, 1932
Assets

Current:		
Cash	$ 22,160	
Notes receivable	150,000	
Accounts receivable	100,000	
Inventories	425,000	$ 697,160
Prepaid expenses		25,000
Fixed:		
Land and property	$10,625,000	
Less: reserves for depreciation	3,420,000	7,205,000
Unamortized bond discount		42,840
Total assets		$7,970,000

Liabilities and net worth

Current:		
Bank loans	$ 950,000	
Other notes payable	250,000	
Accounts payable	230,000	
Accruals	90,000	$1,520,000
First-mortgage 6 per cent sinking-fund gold bonds, maturing January 1, 1941 (a)		2,100,000
Net worth:		
Capital stock—		
Preferred 7 per cent stock, authorized 25,000 shares, par value $100 each, issued and outstanding 20,000 shares	$ 2,000,000	
Common stock, authorized 350,000 shares no par value, stated value $10 each, issued and outstanding 305,000 shares	3,050,000	
	$ 5,050,000	
Paid-in surplus—excess of sale price of common stock over stated value thereof	575,000	
Earned surplus	1,275,000*	4,350,000
Total liabilities and net worth		$7,970,000

* Denotes red figures.
(a) Sinking fund payment of $100,000 due May 1, 1932, has not been paid.

Problem 36

(Ohio, May, 1935)

You have completed an examination of the books of account of The Meat Packing Company for the year ended December 31, 1934, and from the following information you are to prepare:

1. Condensed comparative statement of income and expense showing operating profit before depreciation and net profit after interest and bad debts but before depreciation.
2. Statement of application of funds showing in detail the effect of the 1934 operations upon the assets, liabilities and net worth.
3. Statement of surplus for the year ended December 31, 1934.

The following information is to be used as a basis for adjustment of the books where necessary:

The goodwill account was created January 1, 1933, when A, former proprietor of the packing house, accepted capital stock of The Meat Packing Company for his net worth.

The assets of A as of January 1, 1933, included: bad accounts receivable, $10,000; preorganization expense, $15,000; personal notes of A, $5,000.

Liabilities not included in statement of net worth by A: accrued delinquent county taxes, $5,000; pending judgment, $5,000, which was settled by The Meat Packing Company for $3,000 in 1934, and this amount was charged direct to administrative expense. The change during 1934 in the reserve account created at organization for reduction of merchandise inventory value was credited direct to plant expense.

Delivery equipment valued at $7,000 (on which depreciation amounting to $3,500 had been accrued to December 31, 1933) was sold for $2,000 on June 30, 1934, and the resulting loss charged direct to selling expense. The appraisal figures for this equipment at January 1, 1933, were $8,000 asset and $3,000 depreciation reserve.

Deposit of $20,000 was made in the sinking fund, and bonds of a like par value were purchased for $19,000 and retired on December 31, 1934.

Investments that cost $10,000 were sold during the year 1934 for $12,000, and the profit credited direct to other income. The balance of the other income accounts was ordinary taxable income.

Preferred dividends were declared and paid December 31, 1933 and 1934.

The following adjustments are to be made: Give effect to an appraisal made January 1, 1933, and provide depreciation at the rates shown.

	Cost per books	Depreciation per books	Appraisal value	Depreciation per appraisal
Land	$110,000		$125,000	
Buildings—2%	220,000	$12,000	275,000	$16,500
Machinery—8%	250,000	57,000	325,000	70,000
Fixtures—10%	25,000	6,600	25,000	6,600
Equipment—20%	30,000	15,000	35,000	17,500

Depreciation on all additions made during a year are calculated at 50 per cent of the annual provision. The depreciation expense has been charged as follows:

	Buildings	Machinery	Fixtures	Equipment
Plant expense	90%	100%	50%	
Selling expense			10%	90%
Administrative	10%		40%	10%

Write off the bad accounts taken over from A, and increase the reserve for doubtful by $8,000 as of December 31, 1933. Write off the entire organization expense. Provide for bond interest at 5 per cent payable semi-annually January 1 and July 1. Use for federal income tax rates 13¾ per cent without any exemption.

Trial balance	December 31, 1933 Debits	December 31, 1933 Credits	December 31, 1934 Debits	December 31, 1934 Credits
Cash	$ 60,000		$ 20,000	
Notes and accounts receivable	196,500		235,000	
Inventories	200,000		250,000	
Sinking-fund cash	1,000		2,000	
Notes and accounts:				
Officers	10,000		15,000	
Investments	25,000		15,000	
Prepaid charges	8,500		12,340	
Land	110,000		110,000	
Buildings	226,000		252,000	
Machinery	265,000		294,000	
Fixtures	26,000		28,000	
Equipment	37,000		40,000	
Organization expense	25,000		25,000	
Goodwill	25,000		25,000	
Notes payable—6%		$ 50,000		$ 50,000
Accounts payable		160,000		227,625
Accrued processing tax		20,000		80,000
Accrued county taxes, bond interest and payroll		10,000		10,000
First-mortgage bonds		200,000		180,000
Reserve for depreciation:				
Buildings		16,460		21,240
Machinery		77,600		99,960
Fixtures		9,150		11,850
Equipment		21,700		25,200
Reserve for doubtful accounts		10,000		22,250
Reserve for reduction of inventory		25,000		15,000
Capital stock:				
Preferred (6% cumulative 3,000 shares)		300,000		300,000

Trial balance	December 31, 1933 Debits	Credits	December 31, 1934 Debits	Credits
Common (no par 3,000 shares)		$ 150,000		$ 150,000
Earned surplus		35,090		148,090
Sales		2,000,000		2,450,000
Other income		18,000		20,250
Purchases	$1,550,000		$2,000,000	
Plant expense	165,000		250,000	
Selling expense	100,000		125,000	
Administrative expense	50,000		75,000	
Other deductions*	23,000		38,125	
Totals	$3,103,000	$3,103,000	$3,811,465	$3,811,465

* Bad debts	$10,000	$12,250
Bond interest	10,000	5,000
Note interest	3,000	3,000
Income tax		17,875

PART II

TYPES OF ORGANIZATION

SECTION IV

SOLE PROPRIETORSHIP AND SINGLE ENTRY

Problem 37

(New York, April, 1936)

A small retail trading company shows the following condition on July 1, 1934:

Cash		$ 700
Notes receivable		4,000
Accounts receivable		7,300
Merchandise inventory		6,500
Furniture and fixtures		3,000
Total assets		$21,500
Notes payable		$ 4,000
Accounts payable		6,700
Total liabilities		$10,700
Capital stock	$10,000	
Surplus	800	
Total net worth		10,800
Total liabilities and net worth		$21,500

During July the bookkeeper wrote up the cashbook and sales register and made no postings to the ledgers. Credit purchases for the month were $9,200; notes payable were renewed, $5,300; customers' allowances were $300. The sales register showed credit sales, $7,600, with a cost of $4,750.

Cash receipts for July were:

Customers	$ 6,000
Notes receivable	3,500
Cash sales (cost $600)	720
Total	$10,220

Cash payments for July were:

Salaries	$ 720
Accounts payable	5,600
Interest on notes payable	20
Rent	150
Miscellaneous expenses	400
Total	$ 6,890

Prepare statements showing financial condition July 31, 1934, and the net profits for July, 1934.

Problem 38

(New York, October, 1936)

You have been asked by Mr. John Doe, who has kept an incomplete set of records, to prepare statements of his business as of December 31, 1935.

The following information is collected from various sources:

	January 1, 1935	December 31, 1935
Notes receivable (customers)	$15,250	$18,000
Accounts receivable	36,500	35,350
Merchandise inventory	41,000	37,950
Accrued interest income	356	
Land	20,000	20,000
Prepaid insurance	610	
Building	49,000	49,000
Machinery	30,000	36,000
Office equipment	1,900	2,000
Notes payable (trade)	30,000	5,000
Accrued interest expense	750	
Accounts payable	27,500	39,500

In summarizing the cashbook for the year, the following information is abstracted:

Receipts		Disbursements	
Bank balance, January 1, 1935	$ 6,580	Creditors	$38,700
Customers	65,400	General expenses	8,800
Notes receivable	13,790	Wages	11,300
Interest	1,210	Interest on notes payable	1,600
Mr. Doe, additional capital	15,000	Purchase of new machinery	6,000
		Purchase of new office equipment	100
		Notes payable	30,000
		Mr. Doe, drawings	4,800

The appraised value of the fixed assets on December 31 is as follows: building $48,020, machinery $32,700, office equipment $1,805.

It is estimated that $1,800 of the accounts receivable will prove uncollectible; $10,000 of the accounts receivable have been pledged as security to a creditor on open account.

Interest has accrued on the following notes receivable:

R. G. Davis, $5,600, 2-month 6 per cent note, dated November 15
Yonker Bros., $8,000, 90-day 5 per cent note, dated December 1
L. F. O'Conner, $4,400, 30-day 6 per cent note, dated December 21

The notes payable account on December 31, 1935, represents a sixty-day 6 per cent note given to a sundry creditor on December 11, 1935. The prepaid insurance on January 1 represents policies for three years purchased for cash on that date and still fully in force. (Calculate interest on 360-day basis.)

Prepare the following:

1. Work sheet.
2. Comparative balance-sheets.
3. Profit and loss statement.

Problem 39

(New York, November, 1934)

Required: On the basis of the information below, prepare the statements that should be included in the report. (Proper explanations of all adjustments made must be provided.)

The Ajax Company came under new management on November 1, 1932. A balance-sheet prepared at that time follows:

THE AJAX COMPANY
Balance-sheet, October 31, 1932

Assets		*Liabilities*	
Cash in bank	$ 5,531.18	Bank loans	$130,000.00
Notes receivable—trade	48,967.42	Accounts payable—raw materials	246,873.19
Accounts receivable—trade	146,781.30	Accrued payroll	50,500.00
		Mortgage payable	70,000.00
Inventory	160,210.90	Capital stock	60,000.00
Land	25,000.00	Surplus	110,907.15
Plant	135,000.00		
Deferred charges	146,789.54		
Total	$668,280.34	Total	$668,280.34

The company was operated by this new group until March 31, 1934, at which time it was decided to hire a professional accountant to go over the books and records and present the

group with correct and proper information concerning the company to date.

On examination, the accountant finds that the balance-sheet of October 31, 1932, was not supported by records worthy of the name and that the same situation is in evidence since that date. However, the following authentic information is uncovered:

1. The item "cash in bank" includes salesmen's advances of $1,610, of which sum not more than $550 is collectible, as the men are no longer employed.
2. Cash payments are not booked until checks issued have been cleared and returned. Checks issued and outstanding October 31, 1932, were $2,916.79, being in payment of raw material accounts payable carrying a discount of 3 per cent.
3. Notes receivable are considered as collectible except that one in the amount of $1,994.32 was to be settled for $525 by agreement between debtor and creditor.
4. The accounts receivable are worthless to the extent of 35 per cent.
5. The inventory contains a charge, offset by a credit to capital stock, of $32,000, represented by an item of original inventory of finished goods. Two years previously this stock was destroyed completely by fire.
6. The remaining portion of the inventory is properly supported by evidence and consists of $90,615.38 of finished goods and $37,595.52 of raw materials.
7. The land value had been increased by the management $16,000, and the plant value $45,000, in 1931.
8. Depreciation is estimated at an average of 7½ per cent per annum for the life of the company, the company being formed as of October 1, 1928.
9. The deferred charges consist of the operating losses for 1929, 1930 and 1931.
10. The liabilities are stated accurately except for some accrued interest which may be ignored.

Between November 1, 1932, and March 31, 1934, cash was received and disbursed as follows:

Receipts	
Notes receivable	$ 46,982.71
Accounts receivable	194,718.33
Interest on notes receivable	488.26
Salesmen	550.00
Sale of one-third of land (mortgage released thereon)	4,500.00
Bank loan	50,000.00
Disbursements	
Raw materials purchased	$38,722.18
Productive manufacturing labor and expense	36,418.27
Selling and administrative expense	69,409.10
Interest on bank loans and mortgage	16,450.00
Bank loans	75,000.00
Accounts payable balances of October 31, 1932	81,641.75
Accrued wages and salaries of October 31, 1932	45,500.00

Also, the following information is obtained:

Accounts receivable—trade—at March 31, 1934	$146,475.19
Notes receivable—trade—at March 31, 1934	864 01
Notes receivable—trade—at October 31, 1932, further uncollectible	371 46
Accounts receivable—trade—at October 31, 1932, worthless	32,987.78
Bad accounts receivable from sales since October 31, 1932	916 44
Accounts payable—raw materials—not paid on March 31, 1934	164,205.93
Unpaid general salaries, March 31, 1934	1,000 00
Finished goods on hand, March 31, 1934, salable	69,401.78
Raw materials on hand, March 31, 1934	31,689.13
Depreciation for period ended March 31, 1934	6,590.00

The salary recorded on the books as unpaid to a former official was canceled by written agreement on the discovery that the official was guilty of cash irregularities.

SECTION V

PARTNERSHIPS—DIVISION OF PROFITS

Problem 40

(American Institute of Accountants, May, 1936)

A, B, C and D are partners in the manufacturing and selling of a patent invented by D. A lent the partnership $50,000 as his contribution to the organization and took a note for the amount. B was an experienced machinist and furnished the use of his complete machine shop, valued at $50,000, for the manufacture of the article exclusively, together with expert supervision. C gave his services as sales manager to create and perfect the partnership's selling organization D turned in his patent at an agreed value of $50,000 as his contribution to the partnership's capital. Each partner was to receive one fourth of the profits. The profits in the first year were $60,000; in the second year $80,000; in the third year $120,000. At the end of the third year the whole business was sold for $500,000 cash. A's note had been paid and the drawings had been: A, $50,000; B, $60,000; C, $50,000; D, $20,000.

Prepare a statement showing the proper disposition and division of all profits. No consideration need be given to anything not specifically mentioned in the problem. Give the reasons for your allocations to the individual partners.

Problem 41

(American Institute of Accountants, May, 1933)

A is the owner of a patent on a mechanical device. In order to arrange for its manufacture and sale, he enters into an agreement with B as follows:

B to advance the funds necessary to manufacture and place the patented device on the market. B's expenditures are to be returned to him out of profits before any division, after which, A and B are to share equally therein.

After a certain period of operation, you are employed to ascertain the amount due A under the contract, the records disclosing the following:

Advances by B	$ 50,000
Accounts receivable	80,000
Accounts payable	25,000
Sales	170,000
Cost of manufacture	80,000
Overhead	10,000
Inventory	30,000
Cash on hand	75,000

(a) Prepare a statement in the form you would render to both A and B.

(b) If there had been an expenditure of $50,000 for machinery and equipment, in addition to the items shown above, what would have been the condition, as between A and B, in conforming with the terms of the contract?

Problem 42

(New York, May, 1935)

The balance-sheet of Ashe, Clarke & Company at January 1, 1934, was as follows:

Cash	$ 17,000	Notes payable	$ 17,000
Notes receivable	20,000	Accounts payable	19,600
Accounts receivable	41,500	H. Ashe, capital	20,200
Inventory	62,500	D. Clarke, capital	43,000
Furniture and fixtures	9,000	W. Dill, capital	50,200
Total	$150,000	Total	$150,000

The copartnership agreement provides that H. Ashe is to receive 5 per cent of the annual profits as compensation for managerial services, that 6 per cent interest is to be allowed on capital accounts and that the remaining profits are to be divided in the ratio 3:4:5 to Ashe, Clarke and Dill, respectively.

On January 1, 1934, subject to the foregoing provisions, J. Bell was admitted to the partnership on payment to the firm of sufficient cash to entitle him to a one-seventh interest.

At December 31, 1934, the accounts show a profit of $75,776.84.

Prepare journal entries for the distribution of the profits to the partners.

Problem 43

(New York, April, 1937)

Using the following information, prepare a balance-sheet as of the close of the year just ended:

X, a small manufacturer, shows the following items in his balance-sheet as of a certain date:

Bank, $500; real estate, $20,000; machinery net, $40,000; accounts receivable, $7,542.50; finished goods, $10,000; goods in process, $1,000; raw materials, $957.50; notes payable, $20,000; accounts payable, $30,000.

Y invests $20,000 in the business, securing a one-half interest. The new firm is to take over the assets of X, exclusive of the real estate; it is to assume all of the liabilities. The goodwill of the business of X is to be taken up on the books of the new firm at $20,000.

Shortly after the new firm began to operate, it was [illegible]overed that the finished goods inventory was overvalued by [illegible]0 and that only $6,500 of customers' accounts was colle[illegible]le. A customer who owed $500 failed before the firm formation, leaving no assets. X knew this and gave instructions to have the account then written off, but the bookkeeper failed to write it off.

The trial balance at the end of the year's business shows:

Bank	$ 26,000	
Accounts receivable	10,000	
Merchandise		$ 75,000
Goodwill	20,000	
Machinery	40,000	
Accounts payable		40,000
X, capital		25,000
X, drawings	2,500	
Y, capital		25,000
Y, drawings	2,500	
Factory wages	35,000	
Nonproductive labor	5,000	
General factory expense	20,000	
Rent	1,500	
General expense	2,000	
Profit and loss	500	
Totals	$165,000	$165,000

The inventories at the close of the year were:

Finished goods	$25,000
Goods in process	2,500
Raw material	2,500

No correction of the discrepancies has been made, and no depreciation has been charged off. Depreciation is to be 10 per cent.

Problem 44

(New York, November, 1931)

On December 31, 1928, the balance-sheet of Anton's business, as a sole trader, appears as follows:

Assets		*Liabilities*	
Cash	$ 1,731.36	Creditors	$ 33,103.56
Customers	29,201.20	Anton, capital	119,629.00
Inventory	37,000.00		
Land	9,000.00		
Buildings	11,489.10		
Machinery	34,310.90		
Goodwill	30,000.00		
Total	$152,732.56	Total	$152,732.56

As of January 1, 1929, a partnership agreement is reached between Anton and Bentley under which it is agreed that:

1. The fixed asset accounts of Anton shall be adjusted to 90 per cent of the values shown, except that goodwill valuation is accepted.
2. The customers' accounts brought in by Bentley shall be valued for capital purposes at what they produce.
3. Profits shall be divided in accord with the average investments for the year.

Bentley's balance-sheet shows the following:

Assets		*Liabilities*	
Cash	$ 1,625.50	Creditors	$19,110.40
Customers	19,741.94	Depreciation reserve	4,096.74
Inventory	32,000.00	Total	$23,207.14
Machinery	20,483.70	Bentley, capital	50,644.00
Total	$73,851.14	Total	$73,851.14

Partnership transactions for 1929 were:

Purchases	$280,471.40
Expenses	104,248.51
Sales	379,485.00
Customers' receipts	380,000.00
Creditors' payments	386,000.00

Other financial activities and adjustments for the year are:

May 1. Anton contributes $18,000.

July 1. Of Bentley's customers' accounts, $12,000 were charged off as bad.

November 1. Anton withdrew $11,500.

December 1. Bentley loaned the firm $6,000 on a noninterest-bearing note due March 1, 1930.

December 31. By agreement, Anton was credited with salary for the year of $5,000; depreciation was estimated at 2½ per cent on buildings and at 10 per cent on machinery.

The mechandise inventory was $38,500.

As of January 1, 1930, Caxton made an investment of $35,000 to secure an interest in the firm. The profit-sharing ratio is now: Anton, 3/5; Bentley, 1/4; Caxton, 3/20.

During 1930, Caxton withdraws $3,000. The profits for 1930 are $18,000.

It is decided that the business shall be wound up. On February 20, 1931, $16,000 is available for distribution, outside debts having been paid. On May 1, 1931, $54,000 is available for distribution. On November 1, 1931, $85,500 is available for distribution. The remaining assets are lost.

Prepare partners' accounts showing loss suffered on dissolution.

Problem 45

(Ohio, May, 1932)

Three individuals, A, C and W, formed a partnership on January 2, 1919, and immediately acquired the necessary plant and equipment to carry on manufacturing operations.

After three years of operations, they decided to call you in, and you were given the following trial balances:

Debits	December 31, 1919	December 31, 1920	December 31, 1921
Cash	$ 10,000	$ 20,000	$ 30,000
Accounts receivable	20,000	30,000	20,000
Note receivable, July 1, 1919, 6 per cent	30,000	30,000	30,000
Land	40,000	40,000	40,000
Buildings—depreciation rate 2½ per cent	50,000	50,000	50,000
Machinery and tools—depreciation rate 10 per cent	60,000	60,000	60,000
Factory fixtures—depreciation rate 10 per cent	70,000	70,000	70,000
Office fixtures—depreciation rate 10 per cent	80,000	80,000	80,000
Raw materials purchased	90,000	170,000	230,000
Productive labor	90,000	150,000	200,000
Manufacturing expenses	80,000	131,900	185.650
Administrative and selling expenses	60,000	110,000	140,000
A—account advances	30,000	40,000	
C—account advances	20,000	40,000	77,130
W—account advances	10,000	50,000	108,550
Credits			
A—account advances			8,580
A—capital account	50,000	50,000	50,000
C—capital account	40,000	40,000	40,000
W—capital account	30,000	30,000	30,000
Accounts payable	80,000	51,900	112,750
Sales at $600 per unit	540,000	900,000	1,080,000

Upon reviewing the partnership agreement, you find that A is to receive 20 per cent of profits, C 30 per cent and W 50 per cent. Losses are to be shared in the same proportion.

Upon further examination, you find that the following items were not entered in the books at the close of each year:

	Prepaid and inventory items		
Raw materials—(inventory)	$10,000	$10,000	
Labor—(prepaid)		3,000	$1,500
Insurance factory—(prepaid)	1,000	750	500
Insurance office—(prepaid)	500	375	250
Advertising—(prepaid)	250	125	
Interest receivable—(accrued)	?	?	?
	Accrued items		
Taxes factory—(accrued expense)	1,000	2,000	1,000
Factory supplies—(unentered invoices)		1,750	1,000
Sales expense—(unentered invoices)	750	500	250

		Accrued items	
The production records showed as follows:			
Units completed during year................	1,000	750	375
Units estimated ½ completed at end of year..	500	250	0

On January 2, 1922, they sold their holdings for $300,000, guaranteeing to the purchaser certain things and therefore contingently receivable in five equal annual installments. The purchaser immediately paid the first installment, and at the end of each year, having decided that the guarantee had been complied with, the purchaser paid the amounts specified.

One of the specific stipulations in the sales agreement was, that unless the guarantee was fully met at the end of each year, the purchaser was not obliged to make further payment.

You are requested to prepare a schedule showing the amount due each upon receipt of each payment and to show upon work sheet profit and loss for each year together with balance-sheet prior to sale.

SECTION VI

PARTNERSHIPS—CHANGE IN INTEREST

Problem 46

(Wisconsin, November, 1934)

From the following information, prepare a statement of partners' accounts at December 31, 1933.

X, Y and Z, attorneys, agree to consolidate their individual practices at December 31, 1932. Assets, exclusive of cash, and liabilities at that date, all of which are taken over by the new partnership, are as follows:

	X	Y	Z
Accounts receivable	$14,248.00	$5,248.60	$15,900.00
Furniture and fixtures	4,300 00	2,500 00	6,200 00
Reserve for depreciation	2,480 00	1,578 00	4,698 00
Accounts payable	100.00	1,480 00	690.00

Each partner is to contribute $5,000 as working capital. Z has leased office space and is bound by the lease until June 30, 1934, the monthly rental being $600. The partners agree to occupy his office space until the expiration of the lease. The partnership is to pay the rent. However, Z's drawing account is to be charged $150 per month, the space having a present monthly rental value of $450. Each partner is to guarantee his receivables contributed to the partnership. No salaries are to be paid to the partners; drawings are to be regarded as advances. The individual partners will receive 20 per cent of gross fees billed to their respective clients during the first year of the partnership. After deducting operating expenses, the balance of fees billed will be credited to the partners' accounts in the following ratios:

X	40%
Y	35%
Z	25%

On April 1, 1933, W is taken into the partnership and is to receive 25 per cent of the fees from new business, after deducting

expense applicable to the new business. Expenses are to be apportioned to new business in the same ratio that total expenses bear to total fees billed.

During the year ending December 31, 1933, fees were billed as follows:

X's clients	$23,400
Y's clients	18,650
Z's clients	10,460
New business:	
Prior to April 1, 1933	3,200
After April 1, 1933	8,030
Total	$63,740

Total expenses, exclusive of depreciation, were $25,380. Depreciation should be computed at the rate of 10 per cent. Charges during the year to partners' drawing accounts were as follows:

W	$1,500
X	5,200
Y	4,450
Z	5,800

Of X's and Y's receivables $1,200 and $450, respectively, proved to be uncollectible.

Problem 47

(American Institute of Accountants, May, 1935)

The following is a statement of the assets and liabilities of the co-partnership of Deed and Seal as at January 1, 1930:

Assets	
Cash	$ 10,279.45
Investment in bonds	28,135.76
Accounts receivable	31,346.21
Inventory	44,281 95
Fixed assets (less depreciation, $2,973.06)	27,654.73
Total	$141,698.10
Liabilities	
Accounts payable	$ 37,602.19
Capital:	
Deed	73,605.74
Seal	30,490.17
Total	$141,698.10

The partnership was dissolved on June 30, 1930. Seal then withdrew and was paid out of the partnership funds his capital, as shown in the statement at January 1, 1930, less withdrawals, together with $8,000 in lieu of his share of profits for the year up to that date. Deed continued the business but on July 1, 1930, was joined in co-partnership by Escrowe who purchased from Deed a one-quarter interest in the partnership for $25,000, the profits thereafter to be divided in the proportions of two-thirds to Deed (his share in the former partnership) and one-third to Escrowe. The books of the old firm, kept by single entry, were not closed when Seal withdrew but were continued by Deed and Escrowe and at December 31, 1930, the following statement was prepared:

Assets	
Cash	$ 17,963.28
Investment in bonds	15,178.33
Accounts receivable	36,524.29
Inventory	57,183.46
Fixed assets (less depreciation, $4,753.69)	43,465.37
Total	$170,314.73
Liabilities	
Accounts payable	$ 47,982.17
Capital	122,332.56
Total	$170,314.73

Deed withdrew $1,000 a month; Seal had drawn $500 a month, and Escrowe withdrew $500 a month. Particulars of the investment in bonds, as shown in the above statements, are as follows:

Cost of $25,000 6% bonds of OK and G Company, interest payable semi-annually, January 1st and July 1st	$28,135.76
Less:	
Proceeds of $12,500 bonds sold June 30, 1930	12,957.43
Balance	$15,178.33

It has been agreed by the parties at interest that the income for the year 1930 is to be apportioned as follows: two-fifths (2/5) for the half year to June 30th and three-fifths (3/5) for the second half year, with the understanding that the loss from the sale of the bonds is a charge against the income of the first half of the year.

Prepare a statement of the three partners' capital accounts and show how you determine the profits.

Problem 48

(Ohio, May, 1936)

On January 1, 1929, A and B organized a partnership to trade in securities. They agreed to share profits and losses equally. A contributed $60,000 cash, and B contributed $40,000, B's experience as an investor and his personal following of customers being considered of sufficient value to equalize A's contribution.

During the first six months ended June 30 the net profits amounted to $20,000 exclusive of unrealized appreciation of $12,000 in securities on hand at the close of that period. At this point it was decided to expand operations and admit C and D into the partnership.

It was agreed that the assets owned by the partnership then had a value of $132,000 and that a value of $18,000 should be placed upon the established business, the total value being $150,000, these values to form the basis for computing future profits.

C and D each contributed $50,000 for their respective 25 per cent capital interests, one-half of each payment being made to A and B and the remainder being paid to the partnership. It was agreed that the earnings and losses should be divided A 25 per cent, B 30 per cent, C 25 per cent and D 20 per cent. The only entry made upon the partnership books at the time of admission of C and D appears in cash receipts with a credit to partnership capital of $50,000.

During the quarter ended September 30 the partnership sold all of its securities at a net profit of $44,000, bringing its total earnings for the nine-months' period up to $64,000, all of which had been retained in the business.

The character of the business had shifted into security underwritings, and at the time of the break in security prices in October the partnership had large holdings of unlisted securities for which there was no market.

Partner D, in order to meet personal financial obligations, withdrew in October $30,000 for which he gave his note to the partnership. Partner A had loaned $15,000 to the firm. The

decline in prices was so severe that the business of the partnership was discontinued November 1, on which date its assets and liabilities appeared on its books as follows:

Cash		$ 21,000
Notes receivable—D		30,000
Unlisted securities		180,000
Total		$231,000
Note payable—A		$ 15,000
Accounts payable		62,000
Capital		150,000
Surplus	$64,000	
Loss: October	60,000	4,000
Total		$231,000

The securities on hand were disposed of with the results shown below. The realization is net after deduction of all expenses. D's affairs were so involved that he could make no payment to the partnership.

	Realization	Cost
November	$42,000	$80,000
December	36,000	60,000
January	28,000	20,000
February	16,000	20,000

Prepare schedule of each partner's account from organization of partnership to completion of distributions, including application of funds monthly during November, December, January and February.

Problem 49

(American Institute of Accountants, November, 1932)

The firm of A, B & C were dealers in securities for their own account and others. On November 30, 1931, the partnership was dissolved because C, whose only capital contribution was his stock-exchange seat, desired to withdraw.

A & B formed a new partnership, taking over all assets and liabilities of the firm, except the stock exchange seat and the goodwill. (The latter was considered worthless.)

Profits and losses were shared in the ratio of 60, 25 and 15 by A, B and C respectively.

In addition to the trial balance given herewith, which reflects all routine adjustments and accruals, the following information was gathered, as of November 30, 1931:

Customers' free credit balances	$ 202,295
Market value of customers' securities short	36,752
" " " firm " "	29,649
" " " " " long	1,009,479

Trial balance November 30, 1931

Corn Exchange bank	$ 63,215	
National City bank		$ 750,000
Failed to receive		185,483
Stock-exchange seat	350,000	
Goodwill	250,000	
Profit on syndicate transactions		215,932
Loss on joint accounts	79,290	
Partners' salaries	51,583	
Interest received		4,592
Dividends received		21,138
Stock Clearing Corporation	10,000	
Failed to deliver	148,660	
Accrued interest		2,265
Interest paid	68,232	
Interest on partner's capital	42,880	
Salesmen, office and general	255,330	
Customers' ledgers	660,313	228,980
Petty cash	852	
Brokerage	7,543	
Commissions		80,533
Firm securities long	1,458,664	
" " short		16,429
Bank of America		270,000
Revenue stamps	565	
Commissions receivable	4,843	
" payable		7,556
Accrued income—syndicates	5,500	
" expense— "		201,677
Capital accounts:		
A		800,000
B		350,000
C		350,000
Drawing accounts:		
A	12,192	
B		16,147
C	31,070	
Totals	$3,500,732	$3,500,732

From the foregoing data, prepare the opening balance-sheet of the new partnership of A & B, as at December 1, 1931.

Problem 50

(New York, April, 1937)

Using the information shown below, adjust and determine the respective partners' capital accounts as of March 31, 1937, and the amount due and payable yearly per agreement by the surviving partners to the executor or administrator of the estate of A.

A, B and C were partners in a merchandising business. The written articles of copartnership provided that profits and losses were to be shared: A, 50 per cent; B, 30 per cent; C, 20 per cent. The articles provided further that in the event of the death of one partner, the survivors were to continue the business, the share of the deceased partner to be paid over to his executor or administrator within three years from day of death in three equal yearly instalments, 5 per cent interest to be paid on unpaid balance.

The net profits of the firm, certified as correct by the partners, were as follows:

1934	$3,995
1935	3,635
1936	3,295

In January, 1937, the copartnership agreement was amended by an addition to the effect that the interest of a deceased partner in the firm was to include his share of firm goodwill, this to be the sum of the net profits of the business for three years prior to, and ending on, day of death.

A died on March 29, 1937. The survivors and A's representative agreed that the partnership should be considered as terminated, in so far as A's interest was concerned, on March 31, 1937.

The assets and liabilities of the partnership as of December 31, 1936, with resulting net worth, were:

Assets		
Cash		$2,500
Notes receivable		2,300
Accounts receivable	$2,300	
Less: Reserve for bad debts	100	2,200
Merchandise inventory		1,665
Total		$8,665
Liabilities		
Notes payable	$1,950	
Accounts payable	2,415	$4,365
Net worth		
A	$1,719	
B	1,505	
C	1,076	$4,300

The following summary of operation results covers the months of January, February and March, 1937:

Merchandise inventory, December 31, 1936: cost, $1,665; retail	$ 2,220.00
Merchandise purchases, three months: cost, $10,479.72; retail	13,099.65
Additional mark-on (net)	300 00
Sales (net)	13,300 55
Markdowns (net)	408.00
Merchandise inventory, March 31, 1937: actual at retail	1,881 10
Notes receivable on hand	2,000 00
Notes receivable under discount at bank. Discount was $15	1,500 00
Customers' balances	2,614 75
Cash payments:	
Salaries and wages	600.00
Rent	225.00
A—drawings	150.00
B—drawings	125 00
C—drawings	100.00
Notes payable	950.00
Accounts payable	5,302.25
Sundry expenses	1,350.00

Problem 51

(Ohio, May, 1931)

A, B, C and D, architects, have been partners since January 1, 1927. The original agreement of distribution of profits was A, 30 per cent; B, 30 per cent; C, 20 per cent; and D, 20 per cent.

During the calendar year, 1928, A, being partly inactive, decided to share his profits with C and D and, therefore, paid them direct one-third each of his proportion for that year, or $7,994.93 each, pending final determination of the correctness of such profits.

During the calendar year 1929 by agreement A did not participate in any profits of the partnership until May 1, 1929, when the original distribution was renewed and continued until January 1, 1930. On July 1, 1929, A renewed his separate arrangement with C and D and intended to pay direct to them one-third each of his profits from July 1, 1929, to January 1, 1930. His payments to them during that period were $3,139.44 each.

The personal records of A show that from May to September, inclusive, 1929, fees aggregating $8,333.33 were received direct by him in equal monthly payments. This receipt was subsequently adjusted by a payment to the partnership by A of 70 per cent of this amount. The bookkeeper allocated this amount to B, C and D in the ratio of 43 per cent, 28½ per cent and 28½ per cent, respectively.

Balance-sheet of the partnership taken as of December 31, 1929, was as follows:

Cash	$ 5,624.51	
Securities	25,550.00	
Leasehold improvements	12,500.00	
Furniture and fixtures	15,312.82	
Library	5,520.00	
Reserve for amortization—leasehold improvements		$ 7,500.00
Reserve for depreciation—furniture and fixtures		3,824.00
Reserve for depreciation—library		1,350.00
Personal accounts		
A		51,901.38
B		4,568.49
C		759.02
D	5,395.56	

The Federal Income Tax Department, after examination of the partnership books, has reduced the depreciation allowable by the following amounts:

	1927	1928
Furniture and fixtures	$1,260.00	$1,425.00
Library	209.00	244.00

Income as shown by the books of the partnership was as follows:

	Receipts	Expenses
Calendar year 1927	$128,679.00	$48,273.58
Calendar year 1928	142,803.00	62,853.72
Calendar year 1929:		
Four months ended April 30	43,777.00	23,035.77
Eight months ended December 31	115,081.55	56,087.89
Two months ended June 30	46,375.25	18,776.03

Partnership withdrawals were as follows:

	1927	1928	1929
A	$ 9,730.16	$ 1,890.65	$20,282.32
B	34,779.40	36,146.51	19,737.17
C	17,579.53	20,142.75	17,962.12
D	18,316.33	21,769.37	21,753.28

Required:

1. Summary statement of partners' accounts after giving effect to adjustments to be made on the books of the partnership.
2. Statement of each partner's income from the partnership by periods.
3. Statement of A's account with C and D by periods.
4. Corrected balance-sheet of the partnership as of December 31, 1929, with certificate letter including your comments upon the adjustments made on the partnership books.

SECTION VII

PARTNERSHIPS—LIQUIDATION

Problem 52

(New York, October, 1937)

Prepare statement showing the distribution of cash on hand. W, X, Y and Z have been partners in business for a number of years, sharing profits and losses as follows: W, 40 per cent; X, 30 per cent; Y, 20 per cent; Z, 10 per cent.

As of June 30, 1937, the partnership agreement terminated by limitation. At this time a balance-sheet of the firm showed the following:

Assets	
Cash	$ 30,500
Customers' balances	30,000
Inventory of merchandise	50,000
Land, buildings and equipment	50,000
W—loan	30,000
X—loan	45,000
Y—loan	22,500
Z—loan	22,500
Total	$280,500
Liabilities	
Notes payable	$106,700
Accounts payable	38,800
W—capital	52,500
X—capital	37,500
Y—capital	30,000
Z—capital	15,000
Total	$280,500

The land, buildings, equipment, customers' accounts and merchandise inventory were assigned to the Blank Company, it being agreed that the Blank Company was to assume and pay

the notes and accounts payable. The partners have no private property.

Problem 53

(American Institute of Accountants, November, 1934)

Adams and Bede commence in business in copartnership on January 1, 1930. Adams contributes $40,000 as capital and Bede $25,000. It is agreed that profits will be divided in the proportions of ⅔ to Adams and ⅓ to Bede and that 6% interest per annum will be credited on the original capitals. No interest is to be charged on drawings or credited on any excess of interest and profits over drawings. During the term of the partnership Adams' drawings amount each year to $10,000 and Bede's to $7,500. At the close of business on December 31, 1932, Bede retires from the firm and is paid from partnership funds the balance standing to the credit of his capital account. The net profits of the partnership were proportionate to the sales which for the three years ended December 31, 1932, respectively amounted to $250,000, $200,000 and $175,000. Adams will continue the business as a sole trader and at the commencement of business on January 1, 1933, prepares the following statement from the books:

Cash	$ 10,203.16
Accounts receivable	16,813.87
Inventories	24,311.97
Prepaid expenses	250.00
Fixed assets	40,000.00
Goodwill	15,000.00
Total assets	$106,579.00
Accounts payable	$ 24,861.05
Notes payable	15,000.00
Accrued liabilities	750.00
Reserves:	
For bad debts	2,500.00
Depreciation	12,000.00
Total liabilities and reserves	$ 55,111.05
Capital	51,467.95
Total	$106,579.00

Prepare a statement of the partners' capital accounts for the three years ended December 31, 1932.

Problem 54

(American Institute of Accountants, November, 1937)

Following is a trial balance of the general ledger of the A B C Manufacturing Company (a co-partnership) at the close of business May 31, 1937, on which date a change in the partnership is contemplated.

A B C Manufacturing Company
Trial balance, May 31, 1937

	Debit	Credit
Cash	$ 22,830	
Accounts receivable	19,135	
Notes receivable	5,400	
Merchandise	52,050	
Machinery and equipment	34,200	
Delivery equipment	3,000	
Drawing account, A	6,000	
Drawing account, B	6,000	
Drawing account, C	6,000	
Life-insurance premiums	18,000	
Reserve for depreciation		$ 27,000
Reserve for doubtful accounts		3,400
Accounts payable		12,750
Expenses payable		975
Capital account, A		62,710
Capital account, B		62,710
Capital account, C		15,000
Sales		235,000
Cash discounts on purchases		980
Recoveries of accounts receivable written off		140
Cash discounts on sales	1,050	
Purchases	65,000	
Factory labor	137,500	
Factory expenses	11,500	
Selling expenses	21,850	
General expenses	11,150	
Total	$420,665	$420,665

The balance in the life-insurance-premiums account represents premiums of $6,000 each paid on three policies, one each on the lives of A, B, and C, respectively. Of this amount $900 was paid during the five months ended May 31, 1937, representing $300 on each of the policies.

Premiums on the policies on the lives of A and B were paid by the firm as a convenience to the partners and the firm as such

has no equity in the policies. The policy on the life of C named the firm as beneficiary and the premiums on this policy were regarded as an expense of the business; this policy had a cash surrender value of $5,100 at May 31, 1937. By agreement the partnership turns over to C by transfer to his capital account the policy on his life for the cash surrender value and relinquishes all rights thereunder.

As a preliminary to the change it was agreed to liquidate the partnership. All accounts and expenses payable were to be paid, the partners' drawing accounts closed into their capital accounts and the life-insurance policies turned over to the respective partners in accordance with the aforestated facts.

The books have been kept on a calendar-year basis, having been closed on December 31, 1936. No provision has been made in the accounts since that date for doubtful accounts or for depreciation. The policy of the firm has been to provide for doubtful accounts on the basis of ½% of sales; and to provide for depreciation at the rate of 10% per annum on machinery and equipment and 20% per annum on delivery equipment.

An inventory of raw materials, work in process and finished product was taken as of May 31, 1937, and found to be $63,250. An inventory of supplies taken at the same date comprised: factory supplies $2,050, selling supplies $100 and office supplies $50.

It was further agreed that the books should be closed and the profit or loss transferred to the respective partners' accounts; the partnership agreement provides that profits or losses are to be shared equally.

The notes-receivable account represented a demand note of partner C in favor of the firm. C asked that this note be charged to his capital account and agreed to make good any debit in his capital account resulting from the liquidation.

A offered to purchase the assets and goodwill of the business for $92,000 as follows:

Accounts receivable less reserve	$14,000
Merchandise	50,000
Machinery and equipment	11,000
Delivery equipment	1,000
Supplies	1,000
Goodwill	15,000
Total	$92,000

He offered to make payment by application of the balance in his capital account to the purchase price, the remainder in promissory notes maturing monthly in equal amounts over a period of 15 months.

This offer was accepted; the cash and notes receivable, properly endorsed, were turned over to B and accepted by him in settlement of his capital account.

Required: (1) the journal entries necessary to give effect to the above transactions on the books of the co-partnership and to close these books; (2) the journal entries required to open the books of the sole tradership established by A to carry on the business, and (3) a work sheet on which the foregoing entries are applied to the above May 31, 1937, trial balance.

Problem 55

(New York, April, 1935)

Blue and Green, partners, agree to take in White as a partner from March 1, 1932. Instead of White's making any capital contribution, it is agreed that he shall let his share of the profits remain in the business as a credit to his capital account until such retentions shall equal a one-sixth interest; it is agreed further that White shall share profits and losses in the amount of $16\frac{2}{3}$ per cent as from the time of admission.

You, as accountant for the firm, prepare a balance-sheet for White's scrutiny as of February 29, 1932, as follows:

Blue and Green
Balance-sheet, February 29, 1932

Assets		*Liabilities*		
Cash	$ 3,200	Accounts payable		$ 6,000
Accounts receivable	12,800	Capital:		
Merchandise	12,800	Blue	$20,000	
Furniture	3,200	Green	10,000	
Goodwill	4,000			30,000
Total	$36,000	Total		$36,000

Because of the depression, overstocking and unfortunate purchases, the firm suffered so great a loss during the first six months that it was decided to dissolve the partnership. You have been called on to examine the books and to prepare the necessary statements related to winding up the firm's affairs.

You prepare a balance-sheet as of August 31, 1932, as follows:

BLUE AND GREEN
Balance-sheet, August 31, 1932

Assets		*Liabilities*		
Cash	$ 500	Accounts payable		$18,950
Accounts receivable	15,100	Capital:		
Merchandise	11,900	Blue	$20,000	
Furniture	3,200	Green	10,000	
Goodwill	4,000			30,000
Total	$34,700			
Deficit	14,250			
Total	$48,950	Total		$48,950

The firm assets are sold at auction: merchandise, $12,200; furniture, $1,350. The accounts receivable were sold without liability to the firm to a collection agency for $10,000. The accounts payable were found to include a note in favor of Blue for $4,500, for a temporary loan made to the firm. Partners have no assets outside the partnership interests.

Problem 56

(American Institute of Accountants, November, 1935)

The capital of the co-partnership of Goe & Gettem amounted to $40,000, of which Goe contributed $25,000 and Gettem $15,000. The arrangement with respect to the distribution of profits was that Goe received 60% and Gettem 40%. The capital contributions referred to represented the amount of the capital of the respective partners immediately prior to the admission of Goode as a partner on January 1, 1933.

By agreement among the three partners the [illegible] contributed capital of the new firm at its inception on January 1, 1933, was to continue at $40,000, Goode to pay to Goe, personally, $10,000 for the transfer from Goe's capital account to Goode's capital account of a one-quarter interest and Goode to have a 20% interest in the profits or losses, thus making the interests in profits and losses of Goe and Gettem 40% each.

The profits for 1933 amounted to $15,000 and during the year Goe withdrew $7,000, Gettem $5,000 and Goode $2,500. A loss of $25,000 was sustained in 1934 and the withdrawals during that year were: Goe $4,000, Gettem $3,000, Goode $2,000.

Goode had advanced $1,000 as a loan and the other liabilities at December 31, 1934, consisted of trade accounts payable.

When it was decided at the end of 1934 to liquidate, the trade creditors were paid in full from the cash on hand and the collections of accounts receivable. Of the then remaining $7,500 assets $6,500 were sold for $1,500 cash. It was agreed that this cash should be distributed before realization of the sole remaining asset of $1,000, the value of which was problematical. Assuming that Goe and Gettem may have to absorb any deficiency on Goode's accounts—

1. How should the $1,500 cash be distributed?
2. How should the proceeds from the sale of the doubtful asset be distributed if $800 is ultimately realized?
3. How if $5,000 is ultimately realized?
4. What is the amount that should be realized so that Goode's share may exactly reimburse his partners for the deficiency assumed by them?

Problem 57

(New York, April, 1936)

A, B and C are partners, sharing profits in the ratio of 5, 3 and 2, respectively. They decide to liquidate the business and dissolve the partnership. The balance-sheet follows:

Cash	$10,000	Accounts payable	$10,000
Accounts receivable	15,000	A—capital	40,000
Inventory	30,000	B—capital	10,000
Plant	15,000	C—capital	10,000
Total	$70,000	Total	$70,000

The cash was divided as follows: A, $4,000; B, $2,000; C, $4,000.

The amounts realized on the other assets and the expenses in connection therewith were as follows:

	Realized	Expenses
1st month	$15,000	$600
2d month	10,000	400
3d month	20,000	900
4th month	9,000	600

Prepare a dissolution statement showing the proper distribution of each monthly instalment.

Problem 58

(American Institute of Accountants, May, 1930)

Following is the trial balance, after closing, of X and Y, a partnership:

	Debit	Credit
Cash	$ 1,000	
Accounts receivable	30,000	
Inventory	15,000	
Automobiles	5,000	
Accounts payable		$15,000
Loan from X		5,000
Capital—X		10,000
" Y		21,000
Totals	$51,000	$51,000

X and Y have disagreed to such an extent that a dissolution of the partnership is mutually decided upon and you have been engaged to realize the firm's assets and liquidate its liabilities. The partnership agreement provides that profits and losses shall be shared equally.

The automobiles are disposed of for $2,500 and the inventory, in its entirety, is sold to another firm for $13,500. The cash received from these sources, together with the cash shown in the trial balance, is distributed forthwith.

Subsequently, you collect the accounts receivable and pay expenses as follows:

	Accounts receivable face amount	Discount allowed	Cash received	Expenses paid
1st period	$ 2,000	$300	$1,700	$500
2nd "	10,000	500	9,500	
3rd "	10,000	600	9,400	600
4th "	8,000	200	7,800	500

At the end of each period indicated above, you make the proper cash distributions.

Prepare a statement showing the separate distributions and the liquidation of the liabilities and capital.

Problem 59

(American Institute of Accountants, November, 1936)

At December 31, 1931, the capital of Burns, Doak & Ray, a copartnership, was as follows:

	Partnership interest	
	Capital	% of profit
Burns	$80,000	40
Doak	50,000	30
Ray	40,000	30

On January 1, 1932, Peters paid to Burns $25,000 for one-fourth of his capital and partnership interest as of that date. The new partnership continued to operate in the old firm name.

The partners are entitled to salaries as follows:

Burns	$15,000
Doak	12,000
Ray	10,000
Peters	7,500

Burns is also entitled to a bonus of 10% of the net profits after treating as an expense the partners' salaries and the bonus.

The operating results for the three years ended December 31, 1934, were:

1932	$30,000	Profit after charging partners' salaries and bonus to Burns
1933	25,000	Loss after charging partners' salaries
1934	10,000	Profit after charging partners' salaries but before charging Burns' bonus

During the period the partners' drawings against the salaries and profits (including bonus in the case of Burns) were:

	Burns	*Doak*	*Ray*	*Peters*
1932	$20,000	$15,000	$10,000	$7,500
1933	15,000	10,000	10,000	7,500
1934	25,000	12,000	10,000	7,500

The partnership was dissolved on December 31, 1934, and the assets were realized with the following results:

1935	Book value	Realized	Loss
January	$175,000	$150,000	$25,000
February	30,000	10,000	20,000
March	34,000	14,000	20,000
Totals	$239,000	$174,000	$65,000

All the firm's creditors were paid in January, 1935, and cash distributions to the partners were made at the end of January and February, with a final payment at the end of March. The costs of liquidation are to be disregarded.

Prepare a statement of the partners' accounts from January 1, 1932, to the final liquidation on March 31, 1935.

Problem 60

(New York, October, 1936)

The firm of Albert and Brown is declared bankrupt. Also, each of the partners, Albert and Brown, is separately declared bankrupt.

Using the figures given below, prepare statement showing the distribution of assets:

	Firm	Albert	Brown
Assets not pledged	$30,000	$10,000	$40,000
Assets pledged	30,000	30,000	50,000
Totals	$60,000	$40,000	$90,000
Unsecured creditors	$65,000	$ 5,000	$ 5,000
Secured creditors	20,000	20,000	30,000
Taxes		25,000	25,000
Totals	$85,000	$50,000	$60,000

SECTION VIII

PARTNERSHIPS—SALE OR CONVERSION TO A CORPORATION

Problem 61

(New York, April, 1937)

Brown and Jones are partners in a mercantile business known as the B and J Company and share profits and losses equally. They agree with Smith to organize the B and J Corporation to take over the business on October 1, 1935. Incorporation was completed September 22, 1935, in New York, with an authorized capital of $50,000, consisting of 5,000 shares of common stock with a par value of $10 per share. Smith subscribes to 800 shares at par, and Brown and Jones each subscribe to 1,600 shares at par. The partners agree to sell their business, exclusive of cash, to the corporation for $30,000, to be applied to their individual subscription accounts. Smith pays his subscription in cash.

The balance-sheet of B and J Company at September 30, 1935, shows the following:

Assets		*Liabilities*	
Cash	$ 2,000	Notes payable	$ 3,000
Accounts receivable	9,000	Accounts payable	7,000
Inventory	8,000	Mortgage payable	4,000
Building	12,000	Brown—capital	11,500
Land	3,000	Jones—capital	10,500
Fixtures and equipment	2,000		
Total	$36,000	Total	$36,000

The partners divide the cash equally, transfer the remaining assets and the liabilities to the corporation and receive stock to the extent of their respective paid-up subscriptions, in accordance with the agreement.

Prepare opening entries for the corporation's books, a balance-sheet of the corporation and a statement of the individual subscription accounts.

Problem 62

(American Institute of Accountants, May, 1936)

The members of the firm Stewart & Co., the balances in their capital and current accounts at the end of the fiscal year and the ratios in which they share the profits are as follows:

	Capital accounts credit	Current accounts debit,* and credit	Share of profits
Stewart	$100,000	$20,000	35%
Green	50,000	30,000	25%
Jones	30,000	7,000*	20%
Smith	20,000	3,000*	20%

The balances in the partners' capital accounts represent the capital originally contributed by each one.

The firm at the end of the fiscal year has sold its entire business to the Stewart Corporation for $300,000, which is the actual net worth of the firm, as agreed between the partners, and the firm has received 3,000 shares of the corporation in full payment. The corporation has thus acquired all the firm's assets and assumes all its liabilities recorded on the books, including the balances in the partners' current accounts.

The four partners intend to retain the same interest in the capital stock and the profits of the corporation as they had in the profits of the firm.

1. You are required to show the settlement between the partners.
2. What will be the settlement between the partners if, under the otherwise unaltered terms of the sale, the corporation does not take over the balances in the partners' current accounts and these balances are settled between the firm and its partners before the sale is consummated, so that the firm's total liability to the individual partners may be restored to the amount of capital originally contributed?
3. What will be the settlement between the partners if, under the otherwise unaltered terms of the sale, the corporation does not take over the balances in the partners' current accounts and the partners agree among themselves that,

for purposes of the settlement, these balances are to be transferred to their respective capital accounts?

Problem 63

(Ohio, May, 1933)

The following is a balance-sheet as of December 31, 1931, showing the financial condition of A, B and C operating a retail furniture store and undertaking establishment combined:

Assets		*Liabilities*	
Cash in bank	$ 12,250	Notes payable:	
Accounts receivable:		Furniture truck	$ 2,510
Furniture store—instalment	140,000	Bank	32,000
Undertaking	42,200	Accounts payable:	
Inventory:		Furniture store	34,500
Merchandise—furniture store	68,300	Undertaking	11,400
Undertaking supplies	9,400	Mortgage payable:	
Investments—real estate	45,000	Funeral home	16,000
—securities	36,000	Reserve for depreciation:	
Personal account receivable		Furniture store	17,140
D (for merchandise)	12,640	Funeral home	3,400
Furniture store building	75,000	Store trucks	2,600
Funeral home	22,000	Funeral cars	2,800
Furniture and fixtures:		Reserve for doubtful:	
Furniture store	3,200	Furniture accounts	20,000
Funeral home	2,800	Undertaking accounts	10,000
Delivery equipment:		Partnership capital	339,640
Furniture store	11,700		
Undertaking	8,200		
Deferred:			
Furniture store	2,100		
Undertaking	1,200		
Total	$491,990	Total	$491,990

Your examination determines the following:

A and B were partners until December 31, 1924.

A, B, C and D were partners until December 31, 1929.

A, B and C were partners until December 31, 1931.

When D retired from the partnership A, B, and C signed a note payable to him in the amount of $27,000.

D went into bankruptcy in 1931 and was determined to be insolvent prior to the end of that year.

There was no specific agreement in any of the partnerships as to division of profits.

By agreement between the partners you are to adjust the records as follows:

	January 1, 1935, to December 31, 1929	Year 1930	Year 1931
Salaries—A	$30,000	$7,200	$7,200
—B	15,000	3,600	3,600
—C	15,000	3,600	3,600
—D	15,000	None	None

Bonus to C—5 per cent of net profits after salaries for calendar years 1930 and 1931.

Salaries paid to partners:

	January 1, 1925, to December 31, 1929	Year 1930	Year 1931
A	$22,600	$7,000	$6,700
B	14,800	3,800	3,100
C	11,600	2,400	3,400
D	12,800	2,200	10,800

Net profits after salaries indicated above, not including D's salary for 1930 and 1931:

January 1, 1925, to December 31, 1929	Year 1930	Year 1931
$202,960	$39,000	$24,000

Net worth of A and B as of December 31, 1924:

A	$74,680
B	12,000

The partners have decided to dissolve the partnership as of December 31, 1931, in the following manner:

A new corporation with authorized capital consisting of 10,000 shares without par value, and known as The C Corporation, will acquire all assets and liabilities of the furniture store including all bank loans and one-third of note of former partner D. In taking over the instalment accounts receivable, C Corporation acts merely as collecting agent and agrees to pay to the former partners annually the total amount collected on such accounts, such distributions being in final liquidation of their

respective partnership interests. Assume the collection of these accounts to be made in the following future periods.

1932	$30,000
1933	36,000
1934	33,000
1935	12,000
Worthless	29,000

For the assets acquired from the partnership, exclusive of instalment accounts receivable, C Corporation will issue its stock to partners as directed, in even 100-share lots on the basis of $10 a share, any fractions to be adjusted in cash.

The partners have agreed that their interests in the uncollected instalment notes shall be in proportion to their respective partnership equities at December 31, 1931, and can be liquidated only as these accounts are collected by C Corporation. Subject to this reservation, the partners agree to distribute the remaining assets and the stock of C Corporation as follows:

To A—Investments in real estate and securities, assuming one-third of note of former partner D and stock of C Corporation for remainder.

To B—All assets and liabilities of the undertaking business, assuming one-third of note of former partner D and stock of C Corporation for the remainder.

To C—Stock of C Corporation.

C Corporation sells to public on December 31, 1931, for cash at $10 a share the remainder of its authorized capital stock not used in payment of assets acquired from the partnership.

You are requested to prepare:

1. Balance-sheets for A, B and The C Corporation as of December 31, 1931.
2. Schedule showing liquidating items as they will appear in partners' accounts through the year 1935.

SECTION IX

CORPORATIONS—ORGANIZATION

Problem 64

(American Institute of Accountants, November, 1936)

A company was incorporated on June 10, 1935, with a capital of $750,000 divided into 30,000 shares of no par value.

On June 20, 1936, it acquired a manufacturing plant and site on the following terms:

The purchase price to be $750,000 (the appraised sound value at June 1, 1936) payable by transfer to the vendor of the entire capital stock; the deal to be closed on June 25, 1936; and the company to take possession on June 30, 1936.

The property to be transferred free of all liens, except a mortgage of $250,000 securing the vendor's note for that amount to his bank. The note is payable on or before July 1, 1937.

The vendor to deposit with that bank 10,000 shares of the company's capital stock as additional security on his note. (The note was not indorsed and no bond was signed by the company.)

The vendor immediately to donate and to return 10,000 shares to the company's treasury, to be sold for working capital.

A public offering to be made on June 25, 1936, at $30 a share, of 20,000 shares, of which 10,000 shares each are to be furnished by the vendor and the company. The vendor to use his best efforts to further the sale of these 20,000 shares.

The proceeds from the first 10,000 shares sold in the public offering to be turned over to the company for working capital. The proceeds from the balance of the shares to be turned over to the bank and to be applied against the

vendor's note. After payment of the note the mortgage is to be canceled.

Prepare the company's opening balance-sheet as of June 30, 1936, on the supposition that:

(a) None of the shares offered had been sold.
(b) 10,000 shares had been sold.
(c) 15,000 " " " "
(d) 20,000 " " " "
(e) None of the shares had been sold, the vendor can not pay his note and the bank takes possession of the collateral.

Problem 65

(New York, October, 1935)

From the following facts prepare an analytic statement of profit and loss for July 1934. (General business expenses need not be prorated to stores.)

A. B. Goes operates three retail grocery stores as a sole trader. Goods are sold from these stores for cash to customers, and from storeroom stock to small dealers on credit. The books of account are kept by single entry.

Additional working capital being needed, three friends agree to provide the necessary funds on the incorporation of Goes' business. The business is incorporated with an authorized capital of $200,000, share par being $100.

Goes agrees to turn over the business to the company as of July 1, 1934, as follows:

1. On appraised values of physical properties.
2. On disclosed values of all the usual salable assets plus existing liabilities.
3. Net worth of Goes is to apply on his stock subscription of $50,000.
4. Goes is to be allowed 25 per cent of the net worth for goodwill.

Other capital-stock subscriptions are as follows:

H. O. Bar	$60,000
M. E. House	50,000
P. D. Moore	40,000

Each of these subscribers is to pay at once in cash a proportionate amount on subscription which altogether (and at all times) must aggregate 50 per cent more than the value of the capital stock to which Goes is entitled from the takeover.

The Blank Appraisal Company reports as follows:

		Reproductive values	Sound values
Land—Store No. 1			$18,000
Buildings—Store No. 1		$21,000	$14,000
Furniture and fixtures:			
Stores		20,000	15,000
General office		2,000	1,000
Storeroom		2,000	1,000
Automobiles		10,000	7,000
Merchandise inventories:			
Storeroom			28,000
Storage (dairy products)			10,000
Stores			22,000
No. 1	$ 8,500		
No. 2	11,000		
No. 3	2,500		

The book accounts disclosed the following:

Cash in bank		$ 3,000
Cash fund in general office		200
Cash in stores		1,000
No. 1	$430	
No. 2	440	
No. 3	130	
Accounts receivable—dealers		5,200
Trade creditors' accounts		44,560
Accrued wages and salaries		1,590
Accrued taxes		200
Unexpired insurance		100
Mortgage on land and buildings		15,000
Dated July 1, 1933; principal payable in 5 years; interest at 6 per cent per annum, payable semi-annually. Interest falling due not yet paid.		
Notes payable (bank):		
Due 3 months from May 1, 1934 (6%)		20,000
Interest payable at maturity.		
Due 3 months from June 1, 1934 (6%)		10,000
This note was discounted.		

The following additional facts are shown on the books of the company at the close of business July 31, 1934, one month after reorganization:

Merchandise purchase (returns herein were $1,500)		$70,000
Stores' sales—cash		50,000
Store 1	$19,000	
Store 2	26,000	
Store 3	5,000	
Sales to dealers		10,000
Issues from general stock (cost)		43,180
To store 1	$16,870	
To store 2	21,360	
To store 3	4,950	
Cost of goods shipped to dealers		9,090

Store expenses:

	Clerks' wages	Rent	Heat, light, cleaning, ice, etc.	Total
Store 1	$670	$180	$ 90	$ 940
Store 2	870	450	140	1,460
Store 3	270	200	70	540
Management and office salaries				770
Storeroom and delivery wages				530
Automobile upkeep				180
Rent of office and storeroom				70
Stationery and office supplies				80
Postage				20
Advertising				150
Freight in				100
Heat, light, janitor (office)				30
Appraisal and audit fees				700
Law and organization expense				500
Telephone				80

Debts of A. B. Goes not uncovered at date of turnover, July 1, 1934:

On trade creditors' accounts	$1,350	
On storage charge ($10 for current month)	40	$1,390

Actual merchandise inventories in store July 31, 1934, were $20,820:

Store 1	$ 9,000
Store 2	10,000
Store 3	1,820

Merchandise stock during July 1934 showed:

Spoiled goods		$300
Storeroom	$120	
Store 1	50	
Store 2	70	
Store 3	60	
Shortage—storeroom		70

The upper floor of Store No. 1 has a tenant who pays $50 per month rental in advance. On July 1, three months were in arrears. During July $100 of this was received.

Insurance expires September 30, 1934. All salaries and wages were payable one-half each on the first and the fifteenth of the month.

Dealers have paid $8,400 on their accounts. Trade creditors have been paid $80,000. (Discount included therein is $680.)

Annual depreciation rates are: buildings, 5 per cent; furniture and fixtures, 10 per cent; automobiles, 25 per cent.

Part of Store No. 1 building also is used for general office and storeroom. The tax year ends December 31. Capital-stock shares as yet are unissued.

Problem 66

(Ohio, November, 1933)

The trial balance of The Fashion Tailoring Company, maker of men's suits, was prepared from the books at October 31, 1933, as follows:

Debits		Credits	
Cash in bank	$ 16,800	Common stock—6,000 shares	$ 600,000
Accounts receivable—trade	100,000	Surplus	123,000
Accounts receivable:		Notes payable to banks	30,000
A. B. Alton	4,000	Accounts payable—trade	81,020
B. C. Bentley	2,000	Accrued commission	11,800
Inventories at November 1, 1932:		Reserve for depreciation:	
Raw material—35,000 yards	35,000	Buildings	9,000
Work in process—36,000 suits	181,000	Machinery and equipment	125,000
Finished goods—25,000 suits	174,000	Office equipment	10,000
		Sales	1,368,000
		Other income	24,000

Debits		Credits	
Prepaid expenses	1,000		
Land	40,000		
Buildings	90,000		
Machinery and equipment	250,000		
Office equipment	20,000		
Purchases—198,350 yards	238,020		
Direct labor	150,000		
Manufacturing expenses	300,000		
Selling expenses	456,000		
Administrative expenses	304,000		
Other expenses	20,000		
Total	$2,381,820	Total	$2,381,820

The stockholders of record were as follows:

A. B. Alton	3,000 shares
B. C. Bentley	1,500 shares
C. D. Comber	300 shares
D. E. Day	1,200 shares
Total	6,000 shares

Alton, Bentley and Comber have decided to withdraw from the business and have interested X. Y. Zander to take over the company. As a result of the negotiations, the following agreement was made:

X. Y. Zander agreed to pay $188,000 to Alton, Bentley and Comber and to give Day $44,000 in stock. In addition to the $188,000, the four stockholders were to receive from Zander cash in proportion to their holdings for the inventories and prepaid expenses, as shown by the balance-sheet at October 31, 1933. The four stockholders were to withdraw the cash in bank, take over the accounts receivable, all of which were good, and to pay off the entire indebtedness of the company. The fixed assets were to be taken over by the corporation presently to be organized at the following appraised values:

	Sound value
Land	$ 30,000
Buildings	70,000
Machinery and equipment	120,000
Office equipment	6,000
Total	$226,000

A new corporation was organized by X. Y. Zander with capital stock of $800,000 par value of which $177,000 was sold for cash to be retained for working capital. Of the remainder, $44,000 par value was issued to Day, as previously stated in the problem, and the balance was issued to Zander.

In order to carry out the provisions of this agreement, you were requested to audit the books for the fiscal year ended October 31, 1933. You found that salesmen were on drawing accounts and that during the year $125,000 had been paid and charged to accrued commissions. The salesmen were allowed 10 per cent commission, payable when the customers' accounts were settled. Before the books were closed, it was customary to pay the difference between the salesmen's drawings and the commissions due. You also found, not entered, an invoice for 1,650 yards of material, amounting to $1,980, the goods having been received on October 28, 1933. No other irregularities were discovered.

The material was cut to pattern, requiring 3½ yards to make a suit. Inventories at the end of the year were taken by you and priced at current year's cost. All the material necessary to complete the suits had been included in work in process at the beginning and the end of the year. The in-process inventory at October 31, 1933, was valued by you at $174,000. The quantities were as follows:

Raw material	60,000 yards
Work in process	20,000 suits
Finished goods	15,000 suits

You are requested to prepare:

1. Manufacturing statement, year ended October 31, 1933.
2. Statement of profit and loss, year ended October 31, 1933.
3. Balance-sheet after new corporation had taken over business.
4. Statement showing amount Alton, Bentley, Comber and Day each should receive as the result of their agreement with Zander.
5. Work sheet in pencil.

SECTION X

CORPORATIONS—REVALUATION AND REFINANCING

Problem 67

(Ohio, October, 1930)

On January 31, 1929, X, president of the Realty Construction Company, purchased 1,450 shares of the company and thereby became the owner of all but two shares outstanding. Capitalization was then changed from common $100 par value to 50,000 shares no-par value, and X received 29,980 shares of the new issue; A and B, the only other stockholders, then subscribed and paid for 2,500 additional shares each at $10 per share.

You are retained to audit the accounts of the company and, after determining the correct profit, adjust the books to give effect to the following, as of December 31, 1929:

Capitalization has been changed to 100,000 shares no-par value. The present stockholders have accepted two shares for one held, and X has sold direct to C 5,000 shares of the new issue at $10 per share, the cash being paid direct to the company. A and B have subscribed to 7,500 additional shares each at $10 per share.

The directors have voted a bonus of $75,000 to be paid to X and declared a cash dividend of $2 per share on the new stock issue. This bonus and the dividends are to be credited to officer's personal account and subscription accounts wherever possible.

An appraisal of the plant and equipment increased the value to $236,550 for cost to reproduce new, less accrued depreciation to December 31, 1929.

An issue of $150,000 first-mortgage 6 per cent gold bonds has been sold to bankers at 94, and the present mortgage payable has been canceled. There is included in the accrued accounts $4,200 interest accrued on the mortgage payable, and the refinancing is estimated to cost $4,000.

After examination of the records, you find three contracts in the process of construction on which no profit has been taken. The total job costs to date have been included in the accounts receivable.

	Contracts and extras	Job costs	Amount of contract completed
Contract 505	$135,000	$ 66,840	75%
Contract 509	210,800	122,810	80%
Contract 510	160,660	140,400	95%

There is due subcontractors, on contract 509, $15,750 for work completed and a credit due for small tools removed from contract 510 amounting to $4,550.

The trial balance before adjustments at December 31, 1929, was as follows:

Cash	$ 140,913	
Government bonds	100,000	
Accounts receivable	428,800	
Notes receivable	27,600	
Plant and equipment	222,100	
Small tools and supplies	18,650	
Officers' personal account	145,000	
Prepaid accounts	14,110	
Notes payable		$ 50,000
Accounts payable		181,700
Mortgage payable		120,000
Accrued accounts		25,800
Reserve for federal taxes		17,510
Reserve for doubtful accounts		12,500
Reserve for depreciation:		
Plant and equipment		75,550
Reserve for insurance		62,640
New stock sold		100,000
Surplus		9,800
Capital stock		300,000
Profit for 1929		141,673
Total	$1,097,173	$1,097,173

Prepare:

1. Balance-sheet after giving effect to the refinancing including comments that you feel necessary.

2. Journal entries to bring the books into agreement with the balance-sheet as submitted.

Problem 68

(District of Columbia, November, 1936)

You are requested to prepare a suitable statement of assets and liabilities of the XYZ bondholders' committee for the XYZ Transit Company. Your statement is to cover all transactions of the committee during the period from January 1, 1927, the date of its inception, to June 30, 1936.

The records of the committee are kept on a cash-receipts-and-disbursements basis. From them you derived the following information:

Cash receipts:	
Proceeds of notes payable to the depositary, the A Trust Company	$440,000
Contributed by the XYZ Transit Company to the committee's expenses	38,500
Total receipts	$478,500
Cash disbursed:	
Depositary fees	$106,000
Fees to attorneys of the committee	45,000
Fees to committee members	7,850
Salary of secretary of the committee	15,000
Interest on notes payable	132,500
Listing of certificates of deposit on the Stock Exchange	58,000
Advertising, interest, principal payments, etc.	37,825
Printing and stationery	29,850
Mailing and postage	15,675
Sundry committee expenses	8,675
Clerk hire	5,925
Total disbursements	$462,300
Deposited with the A Trust Company	$ 16,200

Other information discovered by you in the course of your examination included the following:

1. Certain liabilities of the committee were unpaid at June 30, 1936; these were—

Interest on notes payable for year ended June 30	$26,400.00
Depositary fees and expenses for the period January 1, 1936, through June 30, 1936....	8,379 26
Fees to committee members and attorneys....	Undetermined

2. The notes payable to the A Trust Company bear interest at the rate of 6 per cent, are due on demand and are secured by $58,000,000 6 per cent bonds of the XYZ Transit Company held by the A Trust Company as depositary.
3. Of $60,000,000 6 per cent bonds of the XYZ Transit Company outstanding, a total of $58,000,000 has been deposited with the committee.
4. The XYZ Transit Company has made payments on principal totaling 35 per cent since January 1, 1927. Interest has been paid to date. Principal and interest payments have passed directly from the Transit Company to the bank, as trustee, and thence to the original bondholders.
5. The depositary agreement provides that expenditures of the committee are to constitute a first lien against deposited securities to the extent of 1 per cent thereof.
6. The agreement also provides that title to the bonds deposited with the committee passes to the committee. Certificates of deposit equal face value to the bonds have been issued to the depositors.

Problem 69

(American Institute of Accountants, May, 1933)

An old, established corporation, whose books have never before been audited by a public accountant, requests you to make an examination of its accounts as of December 31, 1931.

As a result of your examination, you find the following items included in the accounts:

Debits	
Appreciation of land....	$ 800,000
Appreciation of buildings....	200,000
Trademarks....	2,000,000
Treasury stock—5,000 shares at cost.... (market value, $30,000)	180,000
Credits	
Reserve for depreciation on appreciation of buildings....	$ 15,000

Capital stock, consisting of 200,000 shares of $50 each	$10,000,000
Surplus balance, including net earnings plus credits arising from book valuations of trademarks, appreciation, etc., and after deduction for all dividends paid or declared	15,000

You have convinced the officers that the values set up for appreciation of land, buildings and trademarks should be eliminated and the treasury stock canceled. Since there is insufficient surplus to absorb these adjustments, it has been suggested that they be made against the stockholders' net equity and that new shares of no par value be exchanged for the present shares outstanding, on the basis of one new share for one old share.

The plan has been duly approved by the stockholders and the change in capital has been properly authorized, effective as of January 1, 1932.

You are now requested to furnish the necessary entries to record the new set up, in order to prepare and submit a balance-sheet as of March 31, 1932. In the period from December 31, 1931, to March 31, 1932, the net earnings from operations amounted to $40,000. No dividends were paid or declared. All the old shares outstanding have been exchanged for the new ones.

(1) Submit your adjusting journal entries, giving effect to the re-organization of capital, the elimination of all items of appreciation and intangibles, and the cancellation of treasury stock.

(2) Show the amount of the capital-stock account at March 31, 1932, and the manner in which the account would be stated on the balance-sheet at that date.

(3) What is the balance in the surplus account at March 31, 1932?

(4) What footnotes, if any, would you place on the balance-sheet submitted as at March 31, 1932?

Problem 70

(New York, November, 1931)

On January 1, 1929, the trial balance of the Acme Manufacturing Company reflected the following debit and credit balances:

	Debits	Credits
Cash	$ 76,275	
Plant 1	1,750,000	
(Purchased January 1, 1920, depreciation 7% annually)		
Accounts receivable	329,831	
Accounts payable		$ 162,810
Prepaid expenses	12,921	
Bonds		2,000,000
(6% 20-year bonds issued January 1, 1920)		
Reserve for depreciation		1,765,964
Inventories	1,733,189	
Plant 2	3,278,200	
(Purchased January 1, 1927, depreciation 8% annually)		
Accrued expenses		8,190
Notes payable		175,000
Plant 3	926,350	
(Purchased June 30, 1926, depreciation 6% annually)		
Surplus		94,802
Preferred stock—par value		1,500,000
Bond discount unamortized	100,000	
Common stock—par value		2,500,000

On June 30, 1929, the company sold plant 1 for $225,000 cash. On September 30, 1929, bankers reorganized the company by paying the existing 6 per cent twenty-year bonds plus accrued interest (interest payable December 31, March 31, June 30 and September 30) out of the proceeds of the sale of $2,100,000 debenture bonds at $92. At the same time the outstanding preferred stock was converted into 16,500 shares of Class A capital stock without par value, liquidating value $115 per share, and the common stock was converted into 12,500 shares of Class B capital stock, without par value. The debenture bonds are convertible into Class B capital stock on the basis of one share for each $100 par value of bonds.

None of the foregoing entries has been recorded on the books. Prepare necessary journal entries and balance-sheet as at September 30, 1929.

Problem 71

(Wisconsin, November, 1934)

The trial balance of the Bellwood Manufacturing Company at April 30, 1934, was as follows:

	Debits	Credits
Cash on hand and in banks	$ 118,656.79	
Trade accounts receivable, net	295,570.01	
Notes receivable	50,941.97	
Inventories—products and supplies at lower of cost or market	811,888.03	
Investments in stocks and bonds at lower of cost or market	169,310.06	
Real estate—appraised July 1, 1928	26,976.35	
Plant and equipment—appraised July 1, 1928	2,801,923.32	
Patents, franchises, etc	52,219.78	
Deferred charges and other assets	62,118.53	
Accounts payable		$ 171,392.76
Notes and acceptances payable		95,216.37
Interest, wages and taxes accrued		15,032.38
Reserve for depreciation on plant and equipment		984,382.76
6%, 30-year first-mortage gold bonds dated July 1, 1928		1,000,000.00
7% cumulative-preferred stock—$50 par		750,000.00
Common stock—Class A—$50 par		750,000.00
Common stock—Class B—5,000 no-par shares		250,000.00
Capital and paid-in surplus		315,973 68
Earned surplus		57,606.89
Totals	$4,389,604.84	$4,389,604.84

In December, 1933, the board of directors submitted to the stockholders a recapitalization plan which would have as its objectives the following purposes:

1. A write-down of the appraisal value of the plant and equipment to present-day prices, in order to reduce annual depreciation charges.
2. Putting the stock on a dividend-paying basis (no dividends have been paid since July 1, 1931, an indenture in the mortgage providing that dividends may be paid only out of net profits derived from operations).
3. A reduction of the present capitalization.

A summary of the plan presented to the stockholders was made as follows:

1. The question of a new 6 per cent cumulative-prior-preferred stock to be exchanged share for share for the 7 per cent preferred issue at the option of the present holders, the new issue to consist of 15,000 shares at $50 par and to be entitled to accumulative dividends from January 1, 1934, before any dividends may be paid on other classes of stock. With each new share of preferred is to be given one share of new common stock in full payment of accumulated dividends prior to January 1, 1934. Accumulated dividends on the 7 per cent issue retained by stockholders are to be paid before dividends are paid to common stock. When exchanged for 6 per cent preferred, the 7 per cent shares are to be canceled.
2. The authorization of a new issue of common stock consisting of 50,000 shares at $20 par. The existing Class A stock is to be exchanged on a share-for-share basis. The Class B stock is to be exchanged on the basis of one-half share of new common stock for each share of Class B stock. The shares of Class A and Class B stocks are to be canceled when exchanged for the new common stock.
3. A write-down of assets in the following amounts:

Plant and equipment	$960,233.40
Patents, franchises, etc	52,219.78
Deferred and other assets	29,654.65
Reserve for depreciation on plant and equipment	412,199.65
Net write-down	$629,908.18

At April 30, 1934, the foregoing plan was ratified by the necessary majority of each class of stockholders.

Immediately (as at April 30) 13,890 shares of the 7 per cent preferred stock were exchanged, and because of intrafamily holdings 100 per cent of the Class A and Class B shares were exchanged.

You are required to set up the necessary journal entries to record properly the foregoing plan and exchanges of stock and to prepare a balance-sheet as at April 30, 1934, after giving effect to your journal entries.

On July 1, 1934, accrued earnings in the form of cash available for dividends were $55,000. Compute the amount of dividends that would be available per share of common stock and the annual percentage yield to the common stock if the same earnings were likewise available at the end of the next following six months. There were no further exchanges or sales of capital stock after April 30, 1934.

Problem 72

(Ohio, November, 1933)

The A Company of Cleveland, Ohio, purchased the business of The Products Company on December 31, 1925, and operated it until December 31, 1928, at which time you were engaged to make an audit for the three years then ended, for which the surplus account shows as follows:

Net profit for the year 1926		$117,900
Net profit for the year 1927		48,504
Dividends paid, 1926	$ 42,000	
Dividends paid, 1927	22,000	
Factory employees bonus, 1926	45,000	
Factory employees bonus, 1927	30,000	
Charitable contributions, 1926	3,004	
Balance, December 31, 1928	24,400	
Totals	$166,404	$166,404

Cash on hand, as listed on the trial balance of December 31, 1928, includes receipts for advances to officers of $2,500 and memorandum of liability to the cashier for $1,000 for funds advanced by him. Cash on deposit when reconciled to amount reported by bank indicates that a check for $5,000 received from an old reliable customer for his December account had been protested and charged back by the bank, but the return of the check had not been entered on the company's books.

Accounts receivable after all necessary adjustments were aged as follows:

December	25%	July 1 to September 30	5%
November	10%	January 1 to June 30	10%
October	5%	Year 1927	30%
		Year 1926	15%

Uncollectible accounts aggregating $54,000 are worthless. These represent all the unpaid amounts for 1926, one-third of those for 1927 and one-half of those for the first six months of 1928. These uncollectible accounts of 1926 and 1927 were actually charged off in the accounts receivable ledger at the close of the respective years, but the general ledger control has not been adjusted.

It was estimated in 1927 that 50 per cent would be recovered on deposits in the bank closed during that year. The loss for purposes of this problem, may be regarded as a nondeductible tax item.

On January 1, 1928, a cost system was put into effect on the basis of standard or budgeted costs. The finished inventory at the beginning of 1928, which was entirely disposed of during the year, was priced at actual cost which also represented the "standard cost" at that date. Early in the year a considerable reduction was made in labor rates which accounted for the large labor variance. This reduction is to continue indefinitely, and the standards for 1929 will be adjusted accordingly. The rate of overhead absorption during 1928 was considered to be normal and will be continued indefinitely.

The company did not pay the bond interest due July 1, 1928, and thereafter or principal payment due January 1, 1929. A bondholders' protective committee was formed in 1929 and proposed the following plan of reorganization:

Bonds and B Company liability to be converted into 6% preferred at par. Accrued interest to be waived if plan is consummated.

Preferred to be converted into 2,000 shares of no-par common.

Present common stock to be surrendered and canceled.

Life insurance policy to be surrendered for working capital.

Officers' salaries to be limited to $30,000 a year.

Prepare (1) pro forma balance-sheet and three-year income and expense statement giving retrospective effect to the proposed plan; and (2) usual statement of income and expense and surplus for the same period.

A Company

Trial balance, December 31, 1928

Cash on hand	$ 2,000	
Cash on deposit	9,000	
Accounts receivable	175,000	
Inventory—raw material, December 31, 1928	125,000	
Inventory—finished December 31, 1928 (standard basis)	270,000	
Advances to officers	14,000	
Life insurance surrender value (available December 31, 1928)	8,000	
Deposits in closed bank	30,000	
Plant and equipment	581,000	
Treasury bonds—$6,000 par value (acquired March 1, 1928)	3,000	
Unamortized portion of bond discount and expense	28,000	
Depreciation reserve		$ 184,000
Accounts payable		149,000
Accounts payable—B Company		180,000
Accrued interest on bonds		9,600
Notes payable—closed bank		22,000
Notes payable—life insurance		3,000
6% bonds (dated January 1, 1926—due $40,000 annually)		320,000
Capital stock—preferred 7% cumulative		200,000
Capital stock—common		200,000
Surplus		24,400
Sales		650,000
Cost of sales	480,000	
Labor variance		50,000
Overhead variance	20,000	
Officers' salaries	55,000	
General and administrative expenses	48,000	
Selling expenses	134,400	
Life insurance premium expense	4,000	8,000
Bond-interest expense	9,600	
Bond-expense amortization	4,000	
Totals	$2,000,000	$2,000,000

Analysis of accounts

	Finished inventory	Raw material inventory	Labor variance	Overhead variance
Debits:				
Inventory, January 1, 1928	$300,000	$ 50,000		
Purchases		225,000		
Labor			$100,000	
Manufacturing expense				$170,000
Transfers	450,000			
Total debits	$750,000	$275,000	$100,000	$170,000
Less credits:				
Transfers to cost of sales	480,000			
Transfers to finished inventory		150,000	150,000	150,000
Balance, January 31, 1928	$270,000	$125,000	$ 50,000	$ 20,000

Income and expense

	1926		1927	
Sales		$1,800,000		$1,250,000
Finished product—beginning	$ 350,000		$ 200,000	
Raw materials—beginning	75,000		100,000	
Raw materials—purchases	700,000		500,000	
Labor	250,000		200,000	
Manufacturing expenses	257,000		212,000	
Life insurance premium	4,000		4,000	
Officers' salaries	60,000		55,000	
General and administrative expenses	60,000		50,000	
Bond interest	12,000		33,600	
Bond-expense amortization			8,000	
Selling expenses	201,000		181,000	
Federal income taxes	13,100	(10%)	7,896	(14%)
Inventory end—finished		200,000		300,000
Inventory end—raw		100,000		50,000
Net profit	117,900		48,504	
Totals	$2,100,000	$2,100,000	$1,600,000	$1,600,000

Problem 73

(Ohio, May, 1933)

Because of trade conditions, The Attractive Package Food Corporation marketed its product at selling prices reduced every

four months during the fiscal year ended March 31, 1933. Likewise, raw materials were purchased on a declining market. Believing prices to have been stabilized and to have reached a permanent level in the last four months of the fiscal year, the board of directors authorized readjustments that would probably improve the position of the company.

The following trial balance at March 31, 1933, was submitted by the chief accounting officer:

Cash on deposit and on hand	$ 2,000
Accounts receivable—trade	48,000
Notes receivable	3,000
Accrued interest receivable	60
Inventories, April 1, 1932	65,440
Returnable containers	2,120
Prepaid expenses	1,200
Land	40,000
Factory buildings	200,000
Machinery and equipment	300,000
Delivery equipment—trucks	4,500
Office equipment	10,000
Purchases	340,000
Direct labor	174,150
Manufacturing expenses	170,980
Depreciation—factory buildings	8,000
Depreciation—machinery and equipment	30,000
Selling and administrative expenses	14,650
Other income and expenses, net	1,190
Total	$1,415,290
Surplus	$ 20,330
Notes receivable discounted	2,000
Reserve for bad debts	10,000
Reserve for depreciation:	
Buildings—7 years at 4%	56,000
Machinery and equipment—7 years at 10%	210,000
Delivery equipment—2 years at 25%	2,250
Office equipment—7 years at 8%	5,600
Bank loans	23,850
Accounts payable—trade	22,000
Notes payable—trade	14,000
Accrued expenses payable	760
Convertible 6% bonds—par $100,000	95,000
Sales	728,500
Common stock—2,250 shares, par $100	225,000
Total	$1,415,290

During the past year, labor rates were not changed, but effective April 1, 1933, a wage-scale reduction of 16⅔ per cent was announced. This will affect direct labor only. Manufacturing expenses will be reduced 20 per cent during the coming year. Selling and administrative expenses and nonoperating items are expected to remain constant.

The following results of an appraisal completed April 1, 1933, by a reputable appraisal company were to be entered on the books:

Classification	Replacement cost new
Land	$ 35,000
Factory buildings	100,000
Machinery and equipment	159,510
Delivery equipment (trucks)	4,500
Office equipment	10,000
Total	$309,010

The appraisers reported the depreciation rates in effect are adequate and therefore will not be changed.

Upon investigation it was found that the cash consisted of the items presented below:

New National Bank	$ 500
Old National Bank—impounded deposits	1,000
Cash on hand	500
Total	$2,000

The trade accounts receivable included charges to customers for the cost of returnable containers, amounting to $10,000, the returnable container account having been credited when the charges were made.

The 6 per cent convertible bonds were issued at 90, half of the discount having been amortized at March 31, 1933, the date on which conversion was made. According to the terms of the agreement, the bonds were convertible at par for preferred stock at 105. One share of stock was issued for each $100 bond, the difference being settled by cash. Disregard bond interest.

The outstanding par common stock was exchanged one share for one and one-third shares of no-par common having a stated value of $75,000.

An analysis of the accounts for the year ended March 31, 1933, developed the following information:

Raw material inventories:

April 1, 1932	30,000 units @	$0.80	$ 24,000
March 31, 1933	50,000 units @	0.40	20,000

Work in process inventories:

April 1, 1932—one-third processed:

12,000 units—	Material	@ $0.80	$ 9,600
	Labor	@ 0.10 (1/3 of unit labor cost)	1,200
	Overhead	@ 0.12 (1/3 of unit overhead cost)	1,440
	Total		$ 12,240

March 31, 1933—One-half processed:

15,000 units—	Material	@ $0.40	$ 6,000
	Labor	@ 0.15 (1/2 of unit labor cost)	2,250
	Overhead	@ 0.18 (1/2 of unit overhead cost)	2,700
	Total		$ 10,950

Finished goods inventories:

April 1, 1932—

20,000 units—	Material @	$0.80	$ 16,000
	Labor	0.30	6,000
	Overhead	0.36	7,200
	Totals	$1.46	$ 29,200

March 31, 1933—

16,000 units—	Material @	$0 40	$ 6,400
	Labor	0.30	4,800
	Overhead	0.36	5,760
	Totals	$1.06	$ 16,960

Manufacturing cost:

Year ended March 31, 1933, 577,000 units @ $1.262426 $728,420

Sales—581,000 units, $728,500:

April 1 to July 31, 1932	190,000 units	@ $1.50	$285,000
August 1 to November 30, 1932	210,000 units	@ 1.25	262,500
December 1, 1932 to March 31, 1933	181,000 units	@ 1.00	181,000
Totals	581,000		$728,500

Purchases—600,000 units, $340,000:

April 1 to July 31, 1932	200,000 units	@ $0.70	$140,000
August 1 to November 30, 1932	200,000 units	@ 0.60	120,000
December 1, 1932 to March 31, 1933	200,000 units	@ 0.40	80,000
Totals	600,000		$340,000

You were requested by the management to

1. Revalue the beginning and ending inventories for statement purposes, reflecting the new cost level resulting from the readjustments outlined.
2. Prepare statement of profit and loss and manufacturing statement to reflect the possible result of operations during the coming year, assuming current prices to have reached a permanent level and the unit volume of sales remains the same. Disregard income tax.
3. Prepare balance-sheet giving full effect to revaluation of assets, exchange of stock, conversion of bonds and other changes you may deem advisable from the information given.

SECTION XI

CORPORATIONS—SURPLUS AND DIVIDENDS

Problem 74

(American Institute of Accountants, May, 1933)

An excerpt from the certificate of incorporation of a certain corporation reads as follows:

"So long as five thousand (5,000) or more shares of $7 cumulative preferred stock shall be outstanding the company shall not pay or declare any dividends in cash or property on any of its outstanding shares (exclusive of the cumulative dividends on outstanding shares of $7 cumulative preferred stock) unless the company shall have, out of its net profits or out of its net assets in excess of its capital, purchased and canceled or redeemed an aggregate number of its $7 cumulative preferred stock equal to the sum of the number of shares hereinafter designated for such purchase or redemption in respect of the calendar year in which such dividend payment is made and also in respect of each previous calendar year subsequent to the calendar year 1927. The number of shares of $7 cumulative preferred stock designated for purchase or redemption in respect of each calendar year for the purposes of the foregoing calculation shall be one-half of that number of shares arrived at by dividing the total number of shares of $7 cumulative preferred stock outstanding on the first day of January of such calendar year by the number of full calendar years which will elapse between the first day of January (such day being included) of the calendar year in respect of which such determination is made and January 1, 1943."

There were 10,000 shares of preferred stock outstanding at January 1, 1928. No shares were subsequently sold and the company acquired preferred stock as follows:

In the year 1929	750 shares
" " " 1930	713 "
" " " 1931	526 "

How many shares of preferred stock will have to be acquired in 1932 and in 1933 to permit the company to pay a dividend in each of those years on its common stock?

Submit your answer in tabular form.

Problem 75

(American Institute of Accountants, November, 1934)

The "A" Telephone Company was incorporated on January 1, 1931, for the purpose of acquiring and holding securities of companies operating telephone systems. The authorized capital stock consisted of 2,500 shares of $6 cumulative preferred stock without par value and 3,000 shares of common stock without par value. The authorized funded debt was $500,000. On January 1, 1934, three years later, the company voluntarily filed a petition in bankruptcy. An attorney for the bondholders' committee has asked you to examine the accounts and records of the company to determine why it was necessary to file such a petition when it had a surplus of $361,500 as shown by the following analysis of the company's surplus account:

Analysis of surplus account
January 1, 1931, to December 31, 1933

Date				Debit	Credit
1- 1-31	Excess of consideration paid in by shareholders, for shares having no par value, over the amount allotted to stated capital, as follows:				$285,000
	Cash paid in by shareholders......		$500,000		
	Capital stock issue:				
	2,000 shares $6 dividend, no par, preferred stock, stated value $100 per share	$200,000			
	3,000 shares no par common stock, stated value $5 per share..............	$ 15,000	$215,000		
	Excess consideration paid in......		$285,000		
1- 1-31	Discount on purchase of 5,000 shares (total authorized) "B" Telephone Company common stock, par value $100 per share. The company entered this stock in its investment account at par, $500,000...........				10,000

Date		Debit	Credit
7- 1-31	Discount on sale of $500,000 par value "A" Telephone Company 6% ten year debenture bonds, dated July 1, 1931	$50,000	
12-31-31	Net profit from operations for the year ended December 31, 1931 (includes $50,000 undistributed profit for the same year, of the "B" company which was taken into earnings by charging that company's current account)		$ 20,000
12-31-31	Dividends declared on preferred stock for the year ended December 31, 1931	12,000	
12-31-31	Dividends waived by shareholders owning 500 shares of preferred stock		3,000
1- 1-32	Discount on purchase of $400,000 par value "C" Telephone Company 5%, twenty year, sinking fund gold bonds, dated January 1, 1922		20,000
6-30-32	Unrealized profit from the exchange of "B" Telephone Company's common stock for 6,000 shares (total authorized) "C" Telephone Company common stock without par value. The latter stock was taken into the investment account at the stated value thereof, namely, $600,000		100,000
6-30-32	Discount on sale of 500 shares of "A" Telephone Company $6 cumulative preferred stock, stated value $100 per share	5,000	
12-31-32	Net profit from operations for the year ended December 31, 1932 (includes $20,000 undistributed profit for the six months ended December 31, 1932, of the "C" Telephone Company which was taken into earnings by charging that company's current account)		10,000
12-31-32	Dividends declared on preferred stock for the year ended December 31, 1932	13,500	
1- 1-33	Discount on purchase of 600 shares of the company's preferred stock. This stock was canceled		9,000
12-31-33	Net loss from operations for the year ended December 31, 1933	15,000	
	Totals	$95,500	$457,000
	Deduct total debits		95,500
	Balance December 31, 1933		$361,500

The articles of incorporation authorize the directors to purchase preferred capital stock which is to be retired from earned surplus.

At the date of filing the petition in bankruptcy, the total investments owned by the company consisted of the 6,000 shares of "C" Telephone Company's common stock and $5,000 par value, United States Treasury bonds. The latter bonds were purchased at par. The "C" Telephone Company went into the hands of a receiver on July 31, 1933.

From the foregoing data prepare an adjusted analysis of surplus account. Comment briefly upon any additional facts which you feel will be of value to your client.

Problem 76

(American Institute of Accountants, November, 1934)

A corporation presents the following condensed statement as of the close of the year:

Cash	$ 90,000	Dividends payable	$....
Other assets	1,510,000	Other liabilities	500,000
		Common stock	500,000
		6% preferred stock	300,000
		8% preferred stock	200,000
		Surplus	100,000
Total	$1,600,000	Total	$1,600,000

The 6% stock is cumulative, the 8% stock is noncumulative, and both participate equally in the remaining surplus profits by being entitled to an extra dividend equal to the excess of any common dividend rate over and above 6% per annum.

A. Compute the book value per share for each class of stock in the following cases:

1. Current year's dividends unpaid.
2. Dividends unpaid for two years.
3. Dividends unpaid for three years.

B. What dividends could legally be declared to the various classes of stockholders, assuming that the 6% stock is non-participating, the 8% stock is participating on the basis stated and no dividends are in arrears?

Problem 77

(American Institute of Accountants, November, 1933)

On the basis of the following data prepare:

1. The surplus section of the balance-sheet that you will submit.
2. Subsidiary schedules showing the computation of the items in this surplus section.
3. The reconcilement between the $5,670,000 shown in your analysis and the amount that will be shown on your balance-sheet.

Your summarized analysis of the surplus of the Electrical Appliance Manufacturing Co. from January 1, 1908, the date of incorporation, to December 31, 1932, the date of your audit, is as follows:

Credits

Date	Description	Amount
Jan. 1, 1908 to Dec. 31, 1932	Net income carried to surplus	$10,000,000
Dec. 31, 1915	By debit to goodwill—as authorized by board of directors	510,000
Jan. 1, 1920	Patents granted to Josiah Thompson on January 1, 1920; donated to the company by him as of January 1, 1920; valued by the board of directors at $340,000 as of January 1, 1920	340,000
Dec. 31, 1920	Premium on common capital stock sold	300,000
Jan. 1, 1923	Profit on sale of plant to subsidiary Company A	100,000
Jan. 1, 1923	Profit on sale of plant to subsidiary Company B	200,000
Jan. 1, 1926	Appreciation by appraisal:	
	Land	200,000
	Building	500,000
	Machinery and equipment	300,000
Jan. 1, 1926	Donation to company of 5,000 shares (being the entire amount) of its preferred capital stock then outstanding	500,000
Jan. 1, 1928	Profit on sale of entire capital stock of subsidiary Company A to outside interests	175,000
Dec. 31, 1931	Discount on common capital stock reacquired and retired	200,000

Date	Description	Amount
Dec. 31, 1932	Discount on $500,000 face amount of the company's first-mortgage bonds reacquired and retired	$ 100,000
Dec. 31, 1932	Reduction of capital stock from par value of $100 per share to the same number of shares with par value of $50 per share, as authorized by the stockholders at special meeting held December 21, 1932	2,000,000
Jan. 1, 1923 to Dec. 31, 1927	Undistributed earnings (i. e., net increase in earned surplus) of subsidiary Company A, taken up by debit to investment in subsidiary Company A	100,000
Jan. 1, 1923 to Dec. 31, 1932	Undistributed earnings (i. e., net increase in earned surplus) of subsidiary Company B, taken up by debit to investment in subsidiary Company B	700,000
	Total credits	$16,225,000

Debits

Date	Description	Amount
Jan. 1, 1908 to Dec. 31, 1932	Cash dividends paid on common stock	$ 8,000,000
Jan. 1, 1915 to Dec. 31, 1925	Cash dividends paid on preferred stock	330,000
Jan. 1, 1925 to Dec. 31, 1932	Dividends on common stock paid in common stock out of earned surplus	1,000,000
Jan. 1, 1915	Discount on sale of 5,000 shares of 6% preferred stock, par value $100 per share, at 85	75,000
Jan. 1, 1923	Discount of 10% on $2,000,000 of 6% First Mortgage 20 year gold bonds dated January 1, 1923	200,000
Dec. 31, 1932	Provide reserve for excess of cost over market value of marketable securities owned at December 31, 1932	200,000
Dec. 31, 1932	Provide reserve for obsolescence of inventory at December 31, 1932	400,000
Dec. 31, 1932	Write off the book value of the Market Street plant abandoned as of December 31, 1932	350,000
	Total debits	$10,555,000
	Balance—net credit	$ 5,670,000

You also have in your papers the following information:

The goodwill account of $510,000 was transferred to the patent account as of January 1, 1923, by order of the board of directors.

The company provided for depreciation at the rate of 3% per annum on buildings and 10% per annum on machinery and equipment, computed on the book value. The company owns or owned the entire capital stock of two subsidiary companies, A and B.

Dividends of $400,000 were received from subsidiary Company B and credited to investment in subsidiary Company B.

A reserve for amortization of patents was provided by annual charges of 1/17 of the charges to the patent account.

The net book value of the Market Street plant at December 31, 1932, was $350,000, which was found to consist of:

	Cost	Appreciation Jan. 1, 1926	Reserve for depreciation
Land	$ 20,000	$ 50,000	
Buildings	200,000	100,000	$ 70,000
Machinery and equipment	300,000	50,000	300,000
Total	$520,000	$200,000	$370,000

SECTION XII

CORPORATIONS—MISCELLANEOUS

Problem 78

(New York, November, 1934)

From the following general ledger balances as at December 31, 1933, prepare a balance-sheet and a statement showing the computation of the book value of a share of common stock:

Cash	$ 31,800
Office equipment	12,000
Accounts payable	82,500
Inventory—merchandise	74,250
Unissued common stock	50,000
Unissued preferred stock	30,000
Premium on sale of capital stock	11,000
Reserve for taxes	13,500
Reserve for depreciation of buildings	30,000
Reserve for future shrinkage of inventory values	7,500
Treasury stock—common	55,000
Reserve for possible loss in accounts receivable	14,750
Reserve for redemption of bonds	79,500
Surplus from donation of stock	44,250
Accounts receivable	88,750
Reserve for depreciation of machinery and tools	37,500
Income taxes payable	25,500
Common capital stock (par $100)	175,000
Land and buildings	315,000
Notes payable	16,650
Reserve for possible accidents	20,000
Notes receivable discounted	19,200
Machinery and tools	95,000
Preferred capital stock (7% cumulative, par $100—dividends paid to July 1, 1932)	100,000
Sinking fund	79,500
Discount on bonds	5,250
Organization expense	5,000
First-mortgage bonds payable	150,000
Reserve for replacements	30,000
Notes receivable	39,200
Reserve for depreciation of office equipment	1,800
Surplus	22,100

Problem 79

(American Institute of Accountants, May, 1936)

The Mean-Well Company allowed its employees to subscribe to its capital stock on an instalment basis. The number of employees and the shares subscribed by each were as follows:

Number of employees	Shares subscribed by each	Total shares
5	1	5
10	2	20
25	5	125
10	10	100
10	25	250
2	50	100
2	100	200
64		800

After all subscriptions were paid the company distributed pro rata 352 additional shares as a special bonus or donation. No fractional shares were to be issued. Employees entitled to less than ½ share received from the company an equivalent in cash at $50 a share; employees entitled to more than ½ share paid the company at the same rate for the scrip necessary to round out their holdings. No deviation from the plan was permitted.

Prepare (1) a columnar schedule showing the number of shares subscribed by and distributed to each employee, the fractional shares sold or bought and the cash paid or received by him; also prepare (2) a summary of the schedule, showing aggregates.

Problem 80

(American Institute of Accountants, November, 1931)

You are engaged to examine the record of capital stock, sold and issued, of the Natural Gas Company, from date of incorporation to March 31, 1931, and to make a detailed audit of the books of account during the period of production—January 1 to March 31, 1931.

The company was incorporated January 2, 1928, with an authorized capital of 500,000 shares of the par value of $1.00 each.

Your perusal of the minute book discloses that, pursuant to the provisions of the statutes of the state in which the company was incorporated, the entire capital stock of the company had been issued to P. Smith, in payment for gas leases, oil leases and contracts obtained from landowners at a fixed annual rental, until production of gas, when the rental would be converted to a royalty of 12½ per cent of the gross value of the gas sold.

It was further disclosed that, under a pre-incorporation agreement, the promoters had sold and collected the proceeds of 205,000 shares of stock at 20 cents a share, which they accounted for as follows:

Proceeds:	
From pre-incorporation subscriptions, 205,000 shares at 20 cents a share	$41,000
Disposition:	
Gas wells—producing	$22,000
Gas wells—abandoned	11,000
Leases expired	451
Leases unexpired	644
Supervision	1,581
Cash in bank	5,324
Total	$41,000

You notice that certain items only are entered on the books of the company and credited, in total, to leases and contracts, viz.:

Gas wells—producing	$22,000
Leases unexpired	644
Cash (by cheque)	5,324
Total	$27,968

This record, together with a cheque payable to the company for the amount of the balance in bank and a legal transfer of all rights, titles and interest secured through these funds, was accepted and approved by the board of directors, which ordered that the record and transfers be given proper entry on the books of the company.

In order to raise funds for development of the gas structure, on which the company now holds the leases, Smith offered to donate to the treasury of the company 100,000 shares of stock for resale. The offer was accepted, approved and ratified by the board of directors, which fixed the resale price at $1.00 a share.

A further offer of Smith to transfer 200,000 shares from his personal holdings for insurance to pre-incorporation subscribers was also accepted and approved, it being understood that any additional stock obligations to pre-incorporation subscribers would be supplied from the treasury of the company.

The treasurer (a man of means) deposited all receipts from the sale of stock in his personal bank account, relying upon the company's bookkeeper for the proper record of transactions. In checking this record you find the treasury-stock account credited with a remittance to cover 5,000 shares of stock donated by Smith, from his personal holdings, to the treasury of the company for transfer to A. Jones, in payment for pre-incorporation assistance to him, and another remittance of 100 shares, issued to replace a lost certificate. You note, also, that the bookkeeper had failed to obtain remittance for 1,250 shares that had been sold and issued. It was further disclosed that the treasurer had, personally, purchased 1,000 shares from a dissatisfied holder of capital stock, the certificate for which was found surrendered and attached to its relative stub without further transfer. Calling attention of the officers to these irregularities, you are requested to make the necessary corrections.

A trial balance, taken from the books, March 31, 1931, was as follows:

Abstracts of title	$ 670	
Accounts payable		$ 26,439
Accounts receivable	1,967	
Automobile	400	
Auto, expense	194	
Camp buildings	720	
Capital stock authorized		500,000
Cash in bank	182	
Casing, pipe, etc., in stores	10,624	
Development costs	112,364	
Equipment and pipe in place	60,000	
Incorporation costs	674	
Interest paid	718	
Land	4,600	
Land contracts		2,700
Leases and contracts	472,032	
Lease rentals	431	
Notes payable		33,947
Revenue from gas wells		6,114
Royalties paid (12½%)	764	

Salary of manager	$ 900	
Sundry expenses	454	
Surplus donated		$100,000
Taxes paid (property)	37	
Traveling	605	
Treasury stock	864	
Totals	$669,200	$669,200

The company has decided to capitalize all development costs and to compute depletion on the basis of 27½ per cent of gross income and depreciation on the productive life of ten years, without salvage value, in the case of camp buildings and equipment and four years on that of the automobile.

Make the necessary adjustments to bring the accounts in accord with the facts presented. Prepare profit-and-loss account for the three months' period—January 1 to March 31, 1931, and balance-sheet as of March 31, 1931.

Is the rate of depletion determined fully deductible for income-tax purposes?

Problem 81

(Ohio, November, 1936)

A, B and C own all of the stock outstanding in the M Corporation in the following proportion: A, 40 per cent; B, 30 per cent; and C, 30 per cent. A died July 15, 1936. The following provision as per insurance trust agreement signed by all stockholders is found in A's will. "All of the stock owned by me in the M Corporation shall be offered to it at the net current asset value of the stock determined by audit as at the close of the month previous to my death; in the event that the insurance payable at my death to the M Corporation is insufficient to cover this value, note of the corporation will be accepted payable within five years from date of my death at 5 per cent per annum."

The minutes of the last meeting held June 1, 1936, include the following resolutions:

"That profit-sharing bonus shall be paid to employees on the basis of 10 per cent of net profits before federal income taxes for the calendar year 1936.

"That dividend of $2 per share shall be paid to stockholders of record June 30, 1936, payable in cash July 5, 1936."

Trial balance, June 30, 1936

Cash	$ 30,000	
Accounts receivable	350,000	
Inventory	500,000	
Land	350,000	
Buildings	230,000	
Machinery and equipment	50,000	
Office equipment	30,000	
Securities—at cost	300,000	
Cash surrender value life insurance—officers	10,000	
Policy loan on foregoing		$ 2,000
Accounts payable		75,000
Notes payable		50,000
Common no-par stock—10,000 shares		1,000,000
Contingent reserve		31,000
Surplus		400,000
Reserve for bad debts		30,000
Reserve for depreciation		110,000
Sales		1,250,000
Cost of sales	840,000	
Operating expenses	260,000	
Other income		16,000
Other deductions	14,000	
Totals	$2,964,000	$2,964,000

The following information is to be used for the purpose of adjusting the accounts as of June 30, 1936, assuming that proper adjustments were made as of December 31, 1935:

Inventory	$480,000
Market value of securities	320,000
(All stocks and bonds with taxable income.)	

	On books	Accrued	Total
Other income:			
Discount earned	$ 7,000		$ 7,000
Interest earned	6,000	$1,000	7,000
Dividends earned	2,000	500	2,500
Received on accounts previously charged off	1,000		1,000
Other deductions:			
Bad debts of prior years charged off	10,000		10,000
Additions to reserve, June 30, 1936		6,000	6,000
Federal income tax assessed in 1936 for year 1933		2,000	2,000
Interest on tax assessment, 6%		260	260
Interest on notes payable	1,500		1,500
Donations	2,500		2,500

Claim for refund of income taxes paid for year 1934 was filed in 1936 and has been approved. The amount claimed, $3,000, was paid when return was filed January 30, 1935.

Cash surrender values of policies, payable to the corporation, on A, B and C at June 30, 1936, were as follows:

	Coverage	Surrender value	Loan	Interest accrued
A	$300,000	$3,800	$2,000	$100
B	250,000	2,600		
C	200,000	3,600		

Accrued taxes, June 30, 1936 (including all but federal income taxes)—$9,000.

Prepaid accounts, June 30, 1936:	
Advertising	$4,000
Depreciation—add to reserve June 30, 1936:	
Buildings	2,300
Machinery and equipment	1,200
Office equipment	1,000

You are to prepare:

Exhibit A—Equity of capital stock in net current assets at June 30, 1936.

Exhibit B—Balance-sheet after giving effect to audit and adjustment caused by the provisions of A's will and trust agreement.

Federal tax information:

Normal tax on corporations—Net taxable income on first $2,000—8 per cent. Over $2,000 not in excess of $15,000—11 per cent. Over $15,000 not in excess of $40,000—13 per cent. Over $40,000—15 per cent.

Surtax on undistributed profits:

Term "adjusted net income" means net income less normal tax.

Term "undistributed net income" means the adjusted net income less dividends paid.

Tax rate—7 per cent of portion of undistributed net income which is not in excess of 10 per cent of adjusted net income:

12 per cent—in excess of 10 per cent but not in excess of 20 per cent as in first "bracket."

17 per cent—between 20 per cent and 40 per cent.

22 per cent—between 40 per cent and 60 per cent.

27 per cent—of portion of undistributed in excess of 60 per cent of adjusted net income.

15 per cent of dividends received is subject to normal tax; all are included in income subject to surtax.

Donations are deductible up to 5 per cent of net income, before deduction of such donations, for both normal tax and surtax.

The company reports its bad debts on a reserve basis.

Disregard social security tax.

PART III

MERGERS AND CONSOLIDATIONS

SECTION XIII

MERGERS AND CONSOLIDATIONS

Problem 82

(New York, October, 1936)

Based on the following information, determine the sales value of the Acme Company, and submit reasons for your conclusion.

The stockholders of the Acme Company agreed unanimously to sell the company to the Boswell Corporation. The Boswell Corporation entered into an agreement under which it is to pay for the Acme Company shares, all being issued and outstanding, the value shown by the books of the Acme Company as of the close of business, June 30, 1936, current depreciation excluded, plus a value for goodwill, this to be arrived at by you as accountant using company net earnings for the five years ended June 30, 1936.

The Acme Company balance-sheet, June 30, 1935, showed:

Assets		
Cash		$35,225.82
Notes receivable		710.50
Accounts receivable		13,845.25
Inventories		36,573.22
Unexpired insurance		526.64
Furniture and fixtures	$24,178 42	
Less depreciation reserve	14,988.01	9,190.41
Automobile equipment		2,828 16
Total assets		$98,900.00
Net worth		
Capital stock		$50,000.00
Surplus		48,900.00
Total net worth		$98,900.00

The following trial balance was taken from the Acme Company books of account, June 30, 1936:

Cash	$ 20,493.02	
Notes receivable	775.50	
Accounts receivable	16,978.80	
Inventories	36,573.22	
Furniture and fixtures	24,262.52	
Depreciation reserve		$ 14,988 01
Automobile equipment	2,828.16	
Accounts payable		4,610.89
Capital stock		50,000.00
Surplus		47,536.02
Sales		258,001 22
Returns and allowances	239 69	
Salaries and wages	35,577 79	
Rent	5,000.00	
Fuel and light	2,588.96	
Traveling expenses	2,035.63	
Insurance	1,838.50	
Stationery and printing	630.21	
Automobile expense	588.81	
Advertising	584.15	
Freight—out	423.63	
Repairs—furniture and fixtures	402 79	
Taxes	159.39	
Commissions	62.68	
Miscellaneous expense	6,121.15	
Purchases	220,000 13	
Purchase discounts		4,265.98
Interest income		190.15
Sales discounts	1,316 40	
Profit and loss	111.14	
Totals	$379,592.27	$379,592.27

The inventory of merchandise June 30, 1936, was $53,234.55. The unexpired insurance at this date was $872.50. The net earnings for the Acme Company in the past have been: 1932, $3,196.18; 1933, $4,685.93; 1934, $6,118.34; 1935, $5,768.56. Dividends at 6 per cent have been paid each year.

Problem 83

(New York, May, 1931)

The Lawson Company was organized under the laws of New York State, beginning business as of January 1, 1930. Its authorized capital consisted of 20,000 shares of no-par stock and 10,000 shares of preferred stock, par value $100. The preferred

stock is entitled to 8 per cent dividends, payable January 1 and July 1 of each year. Its stated capital is $20,000, represented by 1,000 shares of no-par common stock, the amount subscribed and fully paid in.

An agreement has been reached under which the Lawson Company takes over the assets and assumes the liabilities of the Newton Company as set out in the latter's balance-sheet dated December 31, 1929, except that the land is to be valued at $90,000 and one account receivable of $660 is bad; the raw-material inventory is valued at market, whereas cost is 5 per cent less, and the finished-goods inventory has been written up 10 per cent. The agreement went into effect as of January 1, 1930, the Lawson Company giving as consideration 4,000 shares of its preferred stock and 8,000 shares of its no-par common stock.

Newton Company
Balance-sheet, December 31, 1929

Cash	$ 40,000	
Accounts receivable	92,000	
Raw material	60,000	
Goods in process	31,900	
Finished goods	44,000	
Supplies	15,000	
Land	80,000	
Buildings (net)	102,000	
Machinery and equipment (net)	160,000	
Tools—factory	8,000	
Drawings and patterns	5,000	
Furniture and fixtures	3,200	
Prepaid insurance	1,200	
Notes payable		$ 6,900
Accounts payable		76,400
Accrued labor		6,200
Accrued salaries—salesmen		1,800
Accrued expenses—salesmen		1,200
Accrued local taxes		3,300
Accrued income taxes—federal		18,200
Reserve for bad debts		1,840
Capital stock		400,000
Surplus		126,460
Totals	$642,300	$642,300

The supplies are divided as follows: factory, $12,000; general, $3,000. The furniture and fixtures: factory, $2,500; general, $700. The accrued labor: direct, $4,200; indirect, $2,000.

On January 15, 1930, Lawson Company sold 2,000 shares of preferred stock at par; and on July 7, 1930, it sold 2,000 shares of its no-par common stock at $25 per share.

No entries have been made on the books of the Lawson Company to record the transactions with the Newton Company and its authorized and subscribed capital.

LAWSON COMPANY
Trial balance, December 31, 1930

Cash	$ 264,290	
Accounts receivable	89,000	
Organization expenses	7,500	
Raw material	491,100	
Supplies—factory	10,600	
Supplies—general	4,000	
Buildings	20,000	
Machinery	50,000	
Tools—factory	5,000	
Labor—direct	446,000	
Labor—indirect	114,750	
Local taxes	10,000	
Notes payable	10,000	
Salaries—salesmen	97,000	
Expenses—salesmen	74,010	
Income tax—federal	18,200	
Reserve for bad debts	1,800	
Superintendence and clerks—factory	30,000	
Fuel, light, etc.—factory	8,950	
Sundry expenses—factory	2,800	
Advertising	10,000	
Freight outward	5,600	
Rent—general	7,200	
Salaries—general	80,000	
Contributions—general	10,000	
Sundry expense—general	4,800	
Cash discounts given	18,000	
Accounts payable		$ 30,400
Cash discounts received		8,000
Sales		1,606,200
Initial capital		20,000
Common capital stock sold		50,000
Preferred capital stock sold		200,000
Dividend on preferred stock	24,000	
Totals	$1,914,600	$1,914,600

The following information is to be considered as of December 31, 1930:

Inventories:	
Raw material	$85,000
Goods in process	51,000
Finished goods	42,000
Supplies—factory	15,000
Supplies—general	4,000
Tools	8,000
Drawings and patterns	4,300
Furniture and fixtures—factory	2,200
Furniture and fixtures—general	600
Prepaid insurance	600
Accruals:	
Labor—direct	$ 6,000
Labor—indirect	1,800
Taxes—local	3,300
Salaries—salesmen	2,200
Expenses—salesmen	1,400
Depreciation:	
Buildings	2½%
Machinery	7½%
(Use revised valuations of December 31, 1930)	
Bad debts—2% of outstanding balances	
Organization expenses to be charged off in three years	
Local taxes: 65% manufacturing; 35% general	
Insurance: 70% manufacturing; 30% general	
Dividends declared during 1930:	
June 15. 4% on $600,000 preferred stock	$24,000
December 15. 4% on $600,000 preferred stock	24,000
December 20. $4 per share no-par common outstanding at December 31	44,000
The common stock dividend is payable on January 15, 1931.	

Requirements:

1. Balance-sheet, December 31, 1930.
2. Profit and loss statement for year 1930.
   Show profit before and after provision for federal income taxes.
3. Journal entries related to Lawson company.
   a. To open books.
   b. To record transactions.
   c. To adjust accounts.
4. Work sheet.

Problem 84

(District of Columbia, November, 1936)

A statutory merger has been effected between Companies A, B and C, and you have been asked to draft the journal entries for A as at October 31, 1936, in order to reflect the changes in the accounts made necessary by its acquisition of the net assets of Companies B and C and to prepare a balance-sheet of Company A after giving effect to these entries. Changes in surplus, on the consolidated basis, should appear on the balance-sheet.

At the date mentioned, the financial position of the companies was as follows:

Assets	A	B	C
Investment in A		$ 15,275.00	
Investment in A's bonds			$ 10,740.00
Investment in B	$ 189,463.26		
Investment in C	254,011.50		
Intercompany accounts	84,795.33		60.72
Unamortized bond discount	6,300.00		
Other assets	686,577.39	336,371.57	374,198.40
Total assets	$1,221,147.48	$351,646.57	$384,999 12
Liabilities			
Trade creditors	$ 241,546.93	$ 81,387.48	$ 63,273.43
Accrued interest on bonds	2,500 00		
5% bonds outstanding	150,000.00		
Intercompany accounts	346.52	25,366.81	59,142.72
Capital stock, par value $100	750,000.00	200,000.00	350,000 00
Earned surplus, or deficit*:			
Balance, January 1, 1936	75,240.52	34,586.35	84,095.25*
Net profit, 10 months	31,513.51	10,305.93	3,321.78*
Cash dividend, July 1	30,000.00*		
Total liabilities	$1,221,147.48	$351,646.57	$384,999.12

The following particulars are given you:

1. A's investment in B was acquired by cash payments to B's stockholders as at January 1, 1924, and consists of 90 per cent of the capital stock of B Company; the surplus of B was then $30,357.18. Earnings since have been $62,535.10; and dividends paid, $48,000.
2. A's investment in C is a 100 per cent interest purchased as at January 1, 1934. The deficit of C on that date was

$87,300.34; a net profit of $4,469.52 was earned in 1934, and a net loss of $1,264.43 was sustained in 1935.

3. B's investment in A was purchased on the market in 1921 (the market on January 1, 1924, was $180 per share); it consists of 200 shares of A's 7,500 outstanding shares of capital stock, including a stock dividend of 100 per cent paid by A on December 31, 1925, and is valued at original cash outlay. These shares will be canceled and retired as at October 31.
4. C's investment in A's bonds, 1939 series, consists of 10 $1,000 coupon bonds, purchased at market on January 1, 1936. Coincident with the merger, the bonds have been canceled and cannot be reissued. A's bonds mature as follows:

Date of maturity	Amount
June 30, 1937	$50,000
June 30, 1939	50,000
June 30, 1941	50,000

The bond discount has been prorated on the basis of prospective interest payable, but no amortization has been made as yet for the year 1936. No interest receivable has been accrued by C since the June 30 semi-annual coupon.
5. The 200 minority shares of Company B are to be purchased for cash at book value as determined by you, B's investment in A remaining unchanged for the purpose of the purchase.

Consistently since the acquisition of its subsidiaries, Company A has presented consolidated financial statements to its stockholders.

Problem 85

(Ohio, November, 1936)

Trial balances, December 31, 1935

	A		B	
Cash	$ 38,000		$118,000	
Accounts receivable	99,400		192,000	
Company B—200 shares	13,600			
Plant assets—cost, January 1	500,000			
Office and delivery equipment			75,000	
Accounts payable		$249,500		$ 36,000
Accounts payable—Company A				84,000

	A		B	
Depreciation reserve		$ 50,000		$ 15,000
Capital stock (100 par)		500,000		400,000
Sales		750,000		600,000
Materials purchased	$470,000		$600,000	
Labor—direct	160,000			
Manufacturing expense	78,000			
Depreciation	50,000			
Administrative and general	82,600		30,000	
Selling expense	51,500		120,000	
Dividend paid	6,400			

To facilitate solution, these companies should be considered as having started business January 1, 1935.

Company B depreciation, $5,000 included in administrative and $10,000 in selling expense.

December 31 inventories were as follows:

Company A		
Material at cost		$ 70,000
In process:		
Material	$58,000	
Labor—direct	30,000	88,000
Finished product—Company A		
Of the product manufactured by Company A during the year, 60 per cent was sold to B at a price 25 per cent less than the selling price to other customers of A. 10 per cent of the manufactured product remained on hand December 31.		
Company B		
Merchandise at cost (consisting wholly of product of Company A)		$200,000

The payment by B on December 31 of a cash dividend to reduce the book value of its capital stock to the par value thereof has not yet been recorded.

A plan of consolidation of A and B effective as of December 31, 1935, has been agreed upon and involves the following steps:

1. Curtailment of administrative expenses $25,000 annually and elimination of $43,900 of selling expenses.
2. Adjustment of A's plant value at December 31, 1935, to a net figure of $360,000 without, however, changing the estimated life of ten years from date of acquisition.
3. Capital of the consolidated company will consist of $500,000 par value 6 per cent cumulative preferred (redeemable at

$105 on January 1, 1940) and 50,000 shares common stock without par value. One share of common stock will be issued for each $5 of consolidated earnings applicable to such stock after giving effect to all economies and adjustments as if they had been in full effect throughout the year 1935. To facilitate solution, you are to make no revaluation of consolidated inventory in giving effect to reduced depreciation resulting from revaluation of plant.

4. The preferred stock will be issued to shareholders of A and B in proportion to the net assets contributed, disregarding the revaluation of assets for purposes of the consolidation. The common stock will be issued in proportion to the net earnings contributed by each company the consolidation.

You are to prepare balance-sheets and income and expense statements of A and B, also of the Consolidated Company as if it had operated with all its benefits through the year 1935; also a schedule showing the shares of the consolidated company distributable to shareholders of A and B, respectively. Disregard taxes.

Problem 86

(District of Columbia, May, 1930)

On December 31, 1929, the La Belle Shoe Company owned 1,420 shares of the XY Company which it purchased in 1927 at $68 per share and 825 shares of the AB Company purchased in 1928 at $86 per share. Book values of these two stocks on the dates of purchase were, respectively, $65.25 and $89.50 per share.

The frozen condition of the assets of the three companies has led to a proposed plan of consolidation and refinancing which has been approved by the directors and stockholders of the three organizations.

The La Belle Company has been chartered with an authorized capital stock of 80,000 shares of 7 per cent convertible preferred stock, par value $25 per share, and 250,000 shares of no-par-value common stock. The conversion privilege can be exercised after May 15, 1930, and up to September 15, 1930, on a basis of two of common for one preferred; thereafter, up to December 31, 1930, on a basis of five of common for three preferred.

All stocks issued by the three companies and outstanding on January 1, 1930, were exchanged for shares in the new organization on the following basis:

1. For each share of La Belle Shoe Company preferred, four shares of the new convertible preferred will be given.
2. For each share of La Belle Shoe Company common, eight shares of the new company's common shares.
3. For each share of XY Company stock, six shares of the new common shares.
4. For each share of AB Company stock, four shares of the new common shares.

An investment banker has underwritten the balance of the stock less 1,200 shares of preferred and 4,000 shares of common which he is to receive as compensation on a basis of $25 per preferred share and $15 per common.

The cash realized from the sale of stock was to be used to retire the first mortgage bonds and collateral trust notes and to liquidate $500,000 in bank loans. Half of the balance was to be applied against the overdraft and trade notes and accounts payable, the other half to be utilized as working capital.

On December 31, 1929, the AB Company owed the La Belle Shoe Company $42,591.19 on open account for goods manufactured for them in 1929. The AB Company had $26,498.07 of this material in inventories on the same date, on which the La Belle Shoe Company had realized a profit of $4,100.56 when sold.

In addition to the cash advances received from the La Belle Shoe Company, the XY Company owed the former organization $110,923.45 on open account for raw materials purchased by the former and billed at cost plus 5 per cent handling charges.

All accounts appearing on the foregoing balance-sheets have been audited and reflect the financial condition of the three companies on December 31, 1929.

You are asked to prepare a balance-sheet of the new company on January 1, 1930, after giving expression to the proposed financing.

On page 175 is a balance-sheet of the three companies on December 31, 1929:

Assets	La Belle Shoe Company	XY Company	AB Company
Cash	$ 3,849.90	$ 2,162.40	
Inventories	794,628.15	129,436.89	$102,417.86
Receivables (less reserve for bad debts)	641,773.62	211,723.04	65,209.47
Investment in subsidiaries	167,510.00		
Unamortized bond discount	6,274.50		
Advance to XY Company	59,178.32		
Deposit on leased machinery	40,000.00		
Leasehold			7,560.18
Land, buildings, equipment (less reserve for depreciation)	1,256,337.61	102,385.45	119,358 10
Goodwill	100,000.00	1.00	
Total assets	$3,069,552.10	$445,708.78	$294,545 61
Liabilities and net worth			
Bank overdraft			$ 1,728.72
Bank loans	$ 715,000.00	$ 60,800.00	39,900.00
Notes and accounts payable to trade	498,276.14	201,518.40	97,243.64
Accruals	55,101.78	9,006.32	2,816.56
6 per cent first-mortgage bonds	950,000.00		
Collateral trust notes			65,000.00
Capital stock:			
6½ per cent preferred—2,500 shares, $100 par value	250,000.00		
Common:			
La Belle Shoe Company—4,500 shares, $100 par value	450,000.00		
XY Company—2,000 shares, $50 par value		100,000.00	
AB Company—1,250 shares, $100 par value			125,000.00
Surplus arising from stock donation	50,000.00		
Earned surplus	101,174.18	74,384.06	*37,143.31
Total liabilities and net worth	$3,069,552.10	$445,708.78	$294,545.61

* Red.

Problem 87

(Ohio, October, 1937)

On September 1, 1936, The Manufacturing Company purchased 50,000 shares of The Production Company's stock for $750,000. It also acquired 10,000 shares by exchange, from the

treasury stock available, of one share of its common ($50 par value) for two shares of The Production Company's stock.

During August, 1937, The Manufacturing Company successfully completed negotiations with the stockholders and creditors of The Production Company to purchase all of the latter's assets, except cash as of the close of business, September 30, 1937. The purchase agreement was as follows:

This agreement made in the City of Columbus, Ohio, on August 21, 1937, by The Production Company, a corporation, duly created, organized and existing under the laws of the State of Ohio (herein called the seller) and The Manufacturing Company, a corporation, duly created, organized and existing under the laws of the State of Ohio (herein called the buyer).

Wherein it is mutually agreed as follows:

1. In consideration of cash, the seller shall sell to the buyer all of the current assets and prepaid expenses, except the cash on hand and in banks, at 90 per cent of book value; all current liabilities shall be assumed by the buyer.
2. In consideration of 10 per cent cash and 90 per cent preferred stock (par $100) of the buyer, the seller shall sell to the buyer all of the plant and equipment at the sound value certified to by The Blank Appraisal Company.
3. In consideration of common stock (par value and also true value $50) of the buyer, the seller shall sell to the buyer its goodwill, patents and trade-marks, the amount of which shall be determined by capitalizing at 20 per cent the average net income from operations for the five years just preceding, in excess of 50 cents per share on the 200,000 shares of the seller's outstanding stock.
4. In the determination of the net income, the items of depreciation and charges to plant and equipment for the aforesaid five years shall be adjusted to the basis of a retrospective appraisal to be submitted by the Blank Appraisal Company. Also, the administrative expenses shall be decreased to $240,000 for each year in which the amounts exceeded this sum.

The books of The Production Company for the five years ended September 30, 1937, revealed the following facts:

	1933	1934	1935	1936	1937
Charges to plant and equipment..........	$ 30,000	$ 20,000	$100,000	$200,000	$ 80,000
Charges for depreciation	200,000	205,000	215,000	240,000	250,000
Administrative expenses	150,000	200,000	250,000	300,000	275,000
Nonrecurring income...		50,000		75,000	
Net income............	100,000	200,000	175,000	320,000	300,000

Balance-sheet at September 30, 1937:

Assets		
Cash on hand and on deposit....................		$ 80,000
Notes and accounts receivable..................		60,000
Inventories....................................		400,000
Prepaid expenses...............................		10,000
First-mortgage bonds sinking fund..............		500,000
Plant and equipment............................	$6,000,000	
Deduct: Reserves for depreciation..............	3,100,000	
Unamortized cost............................		2,900,000
Goodwill, patents and trade-marks.............		500,000
Total assets..........		$4,450,000
Liabilities, capital and surplus		
Notes and accounts payable....................		$ 250,000
Accrued items..................................		100,000
First-mortgage bonds due January 1, 1938		700,000
Common stock, 200,000 shares no par value......		2,000,000
Earned surplus.................................		1,400,000
Total liabilities, capital and surplus..... . ..		$4,450,000

The appraisal submitted as of September 30, 1937, shows the following:

	1933	1934	1935	1936	1937
Correct charges to plant and equipment instead of charges per books.	$ 40,000	$ 25,000	$150,000	$260,000	$ 90,000
Correct charges for depreciation instead of charges per books.........	150,000	160,000	180,000	200,000	220,000
Reproductive new at September 30, 1937					7,000,000
Accumulated depreciation...........					3,600,000
Sound value....					$3,400,000

Immediately after the close of the fiscal year, the two corporations executed the agreement. The Production Company liquidated its liabilities, paid $30,000 in cash for the expense of fulfilling its agreements and distributed the remaining cash and stock to its stockholders.

Required:

1. Statement showing adjustment of net income for computation of goodwill and the computation thereof for The Production Company.
2. Work sheet showing adjusted balance-sheet of The Production Company and the amounts available for distribution to its stockholders. (In pencil.)
3. Journal entries giving effect to the transactions on the books of The Production Company.
4. Journal entries eliminating from the books of The Manufacturing Company, the investment in The Production Company stock.

Disregard income tax and bond interest.

Problem 88

(District of Columbia, May, 1931)

On January 1, 1926, the Milander Products Company purchased the entire capital stock of the Morgan Company for a cash consideration of $22,000. The following balance-sheets of the Morgan Company at December 31, 1925, 1929 and 1930, and the supplementary information following were obtained by you from the books of the two companies. Prepare the necessary adjusting journal entries of the books of both companies at December 31, 1930.

	December 31		
Assets	1925	1929	1930
Cash	$ 834.65		
Rents receivable	2,568.42	$ 2,056.20	$ 1,860.51
Unexpired insurance	385.18	463.80	463.80
Equipment	10,899.53	22,481.93	22,481.93
Goodwill	46,000.00	46,000.00	46,000.00
Deficit	7,935.58	7,935.58	7,935.58
Total assets	$68,623.36	$78,937.51	$78,741.82

	December 31		
Liabilities and net worth	1925	1929	1930
Accounts payable	$13,303.54	$ 2,035.17	
Reserve for depreciation	3,169.82	8,439.13	$10,687.32
Milander Products Company	2,150.00	18,463.21	18,054.50
Capital stock	50,000.00	50,000.00	50,000.00
Total liabilities and net worth	$68,623.36	$78,937.51	$78,741.82

The books of the Morgan Company have not previously been audited, and the following information was obtained during the course of the present examination:

Accounts payable at December 31, 1925, were understated by $1,483.21, and this amount was charged to expense in 1926 when paid.

All cash receipts and disbursements since January 1, 1926, have been handled by the Milander Products Company and entered in the current account with the Morgan Company. The nominal accounts on the Morgan Company books are closed to Milander Products Company's current account at the end of each year.

The following profit and loss statement of the Morgan Company for the year ending December 31, 1930, was presented to you:

Particulars	Amount	
Rents received		$26,242.67
Rents paid	$12,000.00	
Depreciation	2,248.19	
Insurance	1,138.19	
Other expenses	8,318.91	23,705.29
Net profit transferred to current account		$ 2,537.38

An analysis of the Morgan Company current account on the Milander Products Company's books follows:

Particulars	Debits	Credits
Balance, January 1, 1926	$ 2,150.00	
Cash disbursements, 1926, 1927, 1928 and 1929	78,421.70	
Cash receipts, 1926, 1927, 1928 and 1929		$84,648.04
Journal entry charging Morgan Company in 1929 for executive services for 4 years at an annual rate of $2,000	8,000.00	
Profits for 4 years ending December 31, 1929, per Morgan Company books	22,539.55	
Totals	$111,111.25	$84,648.04

Balance, January 1, 1930	$ 26,463.21	
Rents paid	12,000.00	
Insurance—one-year policy expiring May 31, 1931	1,138.19	
Payment of Morgan Company's December 31, 1929, accounts payable	2,035.17	
Other expenses, of which $639.12 is applicable to 1929	8,318.91	
Rents received including receivable at December 31, 1929, of $2,056.20		$24,382.16
Rents receivable at December 31, 1930		2,360.51
Journal entry at January 1, 1930, transferring $2,056.20 receivable to Milander Products receivable ledger		2,056.20
Totals	$ 49,955.48	$28,798.87
Balance, December 31, 1930		21,156.61
Totals	$ 49,955.48	$49,955.48

On the Morgan Company's books the Milander Products Company's account contains the following items:

Particulars	Debits	Credits
Balance, January 1, 1926		$ 2,150.00
Cash disbursed by Milander Products Company		78,421.70
Cash collected by Milander Products Company	$84,648.04	
Profit for 4 years ending December 31, 1929 (per books)		22,539.55
Totals	$84,648.04	$103,111.25
Balance, January 1, 1930		$ 18,463.21
Cash disbursed by Milander Products Company, 1930		23,492.27
Cash collected by Milander Products Company, 1930	$24,382.16	
Net profit for the year ending December 31, 1930		2,537 38
January 1, 1930, receivables transferred to Milander Products Company	2,056.20	
Totals	$26,438.36	$ 44,492.86
Balance, December 31, 1930	18,054.50	
Totals	$44,492.86	$ 44,492.86

During 1930 additional equipment at a cost of $6,000 was purchased by the parent company for the Morgan Company and charged to the investment account, increasing the balance therein at December 31, 1930, to $28,000.

The proper rates of depreciation for 1930 are 10 per cent on the equipment balance at the beginning of the year and 5 per

cent on additions. Unexpired insurance at January 1, 1930, amounting to $463.80, covers the first five months of 1930. The rents receivable at December 31, 1930, are understated by $500 on the Morgan Company books, but the correct amount was set up on the books of the parent company. During 1930 neither company made the entry necessary to take up the $2,000 annual charge for executive services made by the Milander Products Company. Rents due Morgan Company are to be carried on their own books rather than on those of the Milander Products Company.

Problem 89

(Ohio, November, 1934)

Company A, a distributor of coal, by investment of $500,000 owns 5,000 shares of stock of Company B, a producer of Dixie Diamond coal.

Early in 1934 A offered to buy the assets and assume the liabilities and contracts of B for the following consideration:

1. Cash for net current assets.
2. 6 per cent debenture bonds, dated January 1, 1934 at par for net appraised value, less mortgage, of fixed assets, except coal lands.
3. Common stock (no par) at $20 a share for all other assets, including advanced royalties.

The proposition was duly accepted by B to be made effective as if consummated on January 1, 1934, after giving effect to the following appraisals, estimates and adjustments:

Unmined coal deposits owned by B on March 31, 1934	40,000,000 tons
Appraised value of plant and equipment of B (adjusted to December 31, 1933)	
Gross value	$ 1,750,000
Depreciation accrued	850,000
Sound value	$ 900,000

Coal lands owned were to be valued at 5 cents a ton for all unmined coal.

An additional reserve of $5,000 was to be allowed with respect to B's receivables. A agrees to acquire and assume, without con-

sideration, all of B's rights and liabilities under a lease covering adjoining coal of the same vein removed through the same mine. The royalty under this lease is 40 cents a ton with a minimum requirement of $1,000 a month, any excess payments being recoverable from future minings.

On March 31, A had on hand 20,000 tons of Dixie Diamond coal for which it had paid $80,000, including freight of $1.50 a ton. On the same date B had on hand 3,000 tons of Dixie Diamond coal.

Stockholders of A authorized $1,000,000 of 6 per cent three-year debentures, an issue of $500,000, 6 per cent cumulative preferred stock, par value $100, and 250,000 shares of common stock without par value. Present shareholders of A were to exchange their old common for new, share for share and agreed to pay cash on April 1, 1934, for all the new preferred at par. It was agreed that the declared common capital of A would remain unchanged.

B Company will sell on April 1 at 85, and accrued interest, all of the debentures to be received from A and then will liquidate and dissolve.

The books of the companies had been closed as usual at December 31, 1933, and the respective account balances at that date were as follows:

	Company A		Company B	
Cash . .	$ 350,000		$ 168,000	
Accounts receivable: Company A			30,000	
Accounts receivable: Other	1,500,000		300,000	
Inventories (Dixie Diamond).	150,000	(37,500 tons)	10,000	(5,000 tons)
Inventories (other coals)	600,000	(200,000 tons)		
Investment—Company B....... 5,000 shares capital stock......	500,000			
Other securities owned..........	24,000			
Coal lands			2.000.000	

	Company A		Company B	
Plants and equipment	$4,500,000		$1,250,000	
Advanced royalties			40,000	
Account payable—Company B		$ 30,000		
Other payables and accruals		550,000		$ 80,000
Dividend payable, January 10, 1934				10,000
Mortgage payable—6% dated December 31, 1930, due December 31, 1935 (Interest payable semi-annually)				300,000
Reserve for depletion				500,000
Reserve for depreciation		1,800,000		700,000
Reserve for bad debts		250,000		50,000
Reserve for contingencies				3,000
Capital stock (no par) 100,000 shares, declared value		500,000		
50,000 shares, declared value				50,000
Capital surplus		2,855,000		2,200,000
Earned surplus		1,639,000		
Deficit			95,000	
Totals	$7,624,000	$7,624,000	$3,893,000	$3,893,000

The separate companies' books had been maintained in the regular way during the three months intervening between January 1 and March 31, 1934, and the following transactions were recorded. Allowances for depreciation may be accepted as adequate for this period.

	Company A	Company B
Sales:		
To Company A		$ 345,000
Other customers	$2,250,000	1,035,000
Purchases and freight	1,001,000	

	Company A	Company B
Yard and delivery expenses	$ 300,000	
Selling and general expense	150,000	$ 305,000
Allowance for depreciation	50,000	23,000
Depletion (4 cts. per ton)		20,000
Royalty expense (4 cts. per ton)		2,000
Labor and mine expense		1,050,000
Interest expense accrued		4,500
Investment income	1,100	
Cash receipts—customers	2,500,000	1,020,000
Cash receipts—Company A		350,000
Cash receipts—investment income	1,100	
Cash payments:		
To Company B	$ 350,000	
Other accounts payable, payroll, etc	1,350,000	$1,300,000
Royalties		3,000
Dividends paid		10,000

Disregarding income-tax features, prepare a balance-sheet as of March 31, 1934, giving effect to the consummation of all of the foregoing including liquidation of Company B.

Problem 90

(Ohio, May, 1937)

You have been retained to prepare:

Balance-sheet of The Furnace Brick Company as of December 31, 1936, after regular audit, adjustments and closing entries.

Consolidated balance-sheet of The Brick Holding Company and The Furnace Brick Company after giving effect to sale and transfer of stock, receipt of cash and inventory as per agreement.

History of The Furnace Brick Company. Organized June 30, 1929, with stated capital of $500,000 and authorized no-par stock 12,000 shares; received subscriptions for 10,000 shares at $50 per share but collected only 80 per cent to June 30, 1936. Owing to lack of funds the construction of the plant was not completed, and the company operated on a partial basis until June 30, 1936, when the management in an effort to complete the plant was able to raise cash in the following manner: collected on stock subscriptions $2.50 per share; sold 1,000 shares for cash at $30 per share after getting an agreement from all stockholders to

accept a reduction in stated value from $50 to $30 per share; obtained $60,000 cash by giving A and B an $80,000 mortgage dated June 30, 1936, at 5 per cent due in ten years.

During the six months ended December 31, 1936, as a result of confusion caused by the completion of the plant, the general ledger was not posted, and the following records obtained by you are to be entered before closing the books December 31, 1936.

In addition to cash received above, the cash account included the following for the period June 30 to December 31, 1936:

Receipts:	
From accounts receivable and sales	$90,000
Summary of vouchers payable:	
Cost of goods manufactured	87,600
Selling expense	5,000
Administrative expense	15,000
Land improvements	3,200
Buildings	12,000
Kilns and dryers	75,200
Machinery	43,000

Adjust accounts for the following inventory and accruals December 31, 1936:

Inventory	$97,600
Accounts receivable	30,000
Prepaid accounts (administrative expense)	2,570
Accounts payable	54,000
Amortize discount in equal amounts over period of 10 years from June 30, 1936	
Interest—none paid to January 1, 1937	
Doubtful accounts—one-half of 1% of sales	
Amortize leasehold over period of 5 years from June 30, 1936	

	Land improvements	Buildings	Kilns	Machinery
Depreciation				
Reserve to June 30, 1936	$2,000	$6,000	$20,000	$24,000
Annual rates	5%	3%	5%	8%

Adjusted on the books to June 30, 1936, you have agreed to increase the reserves for additions June 30 to December 31, 1936, on the basis of 25 per cent of annual rate for this period. Depreciation for the first six months of 1936 has already been charged

to deficit account at June 30, 1936, the close of the company's fiscal year.

After completing the report for December 31, 1936, the company, being still in need of working capital, entertains the following proposal from a group of investors interested in the same industry:

Proposal.—That The Brick Holding Company be organized as of December 31, 1936, with a stated capital of $500,000, the outside group to furnish $100,000 cash and $25,000 inventory for 60 per cent of the common stock to be issued without par value and a one-year note for $25,000 at 5 per cent interest; the stockholders of The Furnace Brick Company to receive for each share held one share of $25 par value 6 per cent noncumulative preferred stock of The Brick Holding Company and one share of the common stock authorized issue without par value.

As of December 31, 1936, 70 per cent of the stockholders of The Furnace Brick Company accepted the proposal and transferred their stock as of that date. It was agreed further by all interested stockholders that stock subscriptions would be canceled upon another payment as of December 31, 1936, of $2.50 per share, and this offer was accepted by all of the holders of the original 10,000 shares in The Furnace Brick Company.

THE FURNACE BRICK COMPANY
Balance-sheet—June 30, 1936

Cash	$ 11,000	
Accounts receivable	20,000	
Inventory	85,000	
Land	18,000	
Land improvements	9,000	
Buildings	38,000	
Kilns and dryers	95,000	
Machinery	68,000	
Leaseholds	10,000	
Stock subscriptions	100,000	
Prepaid accounts	2,000	
Organization expense	4,000	
Accounts payable		$ 24,000
Reserve for depreciation		52,000
Reserve for doubtful accounts		4,000
Capital stock—authorized 12,000 shares no par, 10,000 shares outstanding		500,000
Deficit	120,000	

Problem 91

(American Institute of Accountants, November, 1930)

From the information following, prepare:

(a) Journal entries, recording the purchase of the investments at April 1, June 30 and September 1, 1929.

(b) Statement showing amount of goodwill and capital surplus arising from consolidation, as at December 31, 1929.

In making an audit of the books of account and records of the Smith Theatre Company and its subsidiaries—the Brown Pictures, Incorporated, and the Green Amusement Company—for the year ended December 31, 1929, you find the following conditions:

The Brown Pictures, Incorporated (hereafter alluded to as "the corporation"), was organized January 1, 1929. The incorporators, owners of theatres in favorable locations, leased their theatres, with equipments, to the corporation for a period of twenty years commencing January 1, 1929, and received, in consideration therefor, all the capital stock of the corporation in addition to an annual fixed rental payable by the lessee in equal monthly instalments in advance on the first day of each month.

The capital stock of the Brown Pictures, Incorporated, consists of 10,000 shares of no par value and was issued, according to the articles of incorporation, for leaseholds appertaining to the leased theatres, appraised by the incorporators at date of organization at $120,000. With reference to the issue of the stock, you find the following journal entry on the books of the corporation:

Leaseholds	$120,000	
To capital stock		$120,000

You also find that during the year 1929, the corporation has amortized the leaseholds by charges to profit-and-loss account on the basis of the lives of the leases.

On April 1, 1929, the Smith Theatre Company purchased from individual stockholders of the Brown Pictures, Incorporated, 5,000 shares of the capital stock of that corporation for $70,000 in cash, and on September 1, 1929, acquired from the remaining stockholders the balance of the stock, which was paid for in the following manner:

(a) 100 shares of the Smith Theatre Company's no-par-value common stock held in the treasury, purchased at $35 a share, the market value being $45.

(b) A sum in cash equal to the increase in the rental under an amendment of the lease of the Star Theatre, one of those originally leased to the Brown Pictures, Incorporated, which had been rented by the Brown Pictures, Incorporated, at date of organization from the stockholders now desirous of selling their stock. The original Star Theatre lease agreement provided for a rental of $60,000 per annum and stipulated that the corporation deposit with the lessors the sum of $60,000 bearing interest at 6 per cent per annum, which was to be applied as rental for the last year of the term. The deposit was made by the corporation on January 1, 1929. The amended lease agreement contained the following provisions:

Term—October 1, 1929, to December 1, 1948
Rental—$72,000 per annum from October 1, 1929, to September 30, 1939
$70,000 per annum from October 1, 1939, to December 1, 1947 (payable as in the case of the first lease)
$60,000 for the balance of the term, covered by the lease deposit originally made by the lessor.

The original lease was canceled and settlement for the lease deposit was made in cash.

(c) Cancellation of the interest accrued on the lease deposit from January 1, 1929, to September 1, 1929, the amount thereof to be credited to the Brown Pictures, Incorporated.

The Green Amusement Company was organized January 1, 1929, with an authorized capital stock of 1,000 shares of no par value issued for cash, in amount $35,000. This company was indebted to the Smith Theatre Company on a note of the face value of $15,000. Owing to the unsatisfactory financial condition of the Green Amusement Company, the Smith Theatre Company accepted the note only after endorsement thereof by 95 per cent of the stockholders of the Green Amusement Company.

With consent of the Smith Theatre Company, the endorsers of the note, anxious to free themselves of their contingent liability, which was likely to become actual, entered into an agreement on June 30, 1929, with the Brown Pictures, Incorporated, whereby they sold to that corporation all their capital stock of the Green Amusement Company upon condition that the Smith Theatre

Company cancel the note and that the Brown Pictures, Incorporated, assume the liability therefor on open account.

The books of the respective companies were closed quarterly. An analysis of the surplus accounts at December 31, 1929, was as follows:

	Smith Theatre Co.	Brown Pictures, Inc.	Green Amusement Co.
Balance—January 1, 1929 . . . . . . (as certified by you)	$ 840,000		
Profits or losses (*):			
3 months ended Mar. 31, 1929	150,000	$120,000	$ 5,000*
3 " " June 30, "	140,000	130,000	9,000*
3 " " Sept. 30, "	175,000	135,000	12,000*
3 " " Dec. 31, "	178,000	140,000	15,000*
Balances—December 31, 1929	$1,483,000	$525,000	$41,000*

The capital stock of the Smith Theatre Company consists of 10,000 shares of no-par-value common stock, issued at $15 a share.

Wherever it becomes necessary, in your calculations, to assume an interest rate, use 6 per cent per annum.

The profits or losses for the three months ended September 30, 1929, may be assumed to have occurred in equal amounts by months.

Given:

The present worth of an annuity payable $1.00 monthly for ten years, the first payment to be made in one month, is $90.075. The present worth of an annuity payable $1.00 monthly for eight years and two months, but with the first payment of the annuity beginning in ten years, or directly after the former annuity ceases, is $[illegible]

SECTION XIV

MERGERS AND CONSOLIDATIONS—STOCK ALLOTMENT

Problem 92

(New York, November, 1934)

Three corporations decide to amalgamate. It is agreed that the total capitalization of the new company is to be $2,000,000, but there is a difference of opinion as to the classes of stock that should be issued and the distribution that should be made to the old stockholders. You are asked to prepare a statement setting forth an equitable plan of capitalization and distribution and the ratios in which the new stock will be exchanged for the old. The information furnished you is as follows:

	Capital stock	Surplus per books	Average annual earnings	Appraised value of net assets
Company A	$500,000	$260,000	$ 66,000	$ 600,000
Company B	300,000	125,000	45,000	450,000
Company C	100,000	50,000	24,000	200,000
Totals	$900,000	$435,000	$135,000	$1,250,000

Problem 93

(American Institute of Accountants, May, 1935)

G and H are domestic companies whose audited balance-sheets of December 31, 1934, are as follows:

Assets	G	H
Cash	$ 15,000	$ 2,500
Accounts receivable—good and collectible	14,000	19,000
Marketable securities:		
Owned by Company G (market value $10,000)	18,000	
Owned by Company H (market value $27,000)		27,000
Investment in Company K (wholly owned) represented by 5,000 shares—at cost (market value $1,000,000)	500,000	
Investment in H—book value (120 shares)	1,200	
Investment in G—book value (800 shares)		80,000
Totals	$548,200	$128,500

Liabilities	G	H
Accounts payable	$ 15,000	
Capital:		
6,000 shares, par value $100	600,000	
10,000 shares, par value $10		$100,000
Surplus		28,500
Deficit (italics indicate red figure)	*66,800*	
Totals	$548,200	$128,500

Under a plan of reorganization the Companies G and H are to be merged at December 31, 1934, to form a company J with an authorized capital of $2,000,000 representing 20,000 shares of $100 each. All shareholders agree to the merger except X who owns 100 shares of G and 2,000 shares of H. However, X will accept for his interest in the two companies an equivalent amount of company K shares at their market value. He will receive cash for any fractional part of a company K share.

The other shareholders will receive company J shares at their par of $100 each. They will pay or receive cash in lieu of fractional J shares and it is intended to pay out the smallest amount of cash to each of the two groups of company G and H shareholders.

1. How many shares of company K and how much cash are distributable to X?
2. How many shares of company J and how much cash are distributable to each of the two groups of shareholders G and H?
3. Prepare the opening balance-sheet of company J.

Problem 94

(American Institute of Accountants, November, 1931)

The condensed balance-sheets of companies A, B, C and D, as at the close of business, December 31, 1930 are as shown on page 192.

The capital stock of the several companies owned by the other companies was purchased at par and is carried on the books at cost in each instance.

A consolidation is proposed and decided upon, and the N Banking Company is engaged to make the necessary arrangements for this purpose. The banking company succeeds in

securing agreements from the stockholders of the four companies, A, B, C and D, all complying with the terms of the proposal whereby a new company is to be organized and known as the X Y Company.

Assets	A	B	C	D
Cash	$ 10,000	$ 20,000	$ 4,500	$ 20,000
Accounts receivable	90,000	180,000	145,000	280,000
" " from B	40,000			
" " " C		50,000		
" " " D			75,000	
Inventories:				
Raw material	75,000	100,000	90,000	100,000
Finished goods	60,000	70,000	80,000	90,000
Investments:				
Capital stock of A				50,000
" " " B	50,000			50,000
" " " C		100,000		50,000
" " " D	10,000			
Plant and property	1,580,000	1,970,000	2,175,000	3,110,000
Totals	$1,915,000	$2,490,000	$2,569,500	$3,750,000
Liabilities	A	B	C	D
Notes payable	$ 90,000	$ 100,000	$ 160,000	$ 220,000
Accounts payable to A		40,000		
" " " B			50,000	
" " " C				75,000
Capital stock	1,000,000	1,400,000	2,000,000	3,000,000
Surplus	825,000	950,000	359,500	455,000
Totals	$1,915,000	$2,490,000	$2,569,500	$3.750,000

During the past five years, dividends have been paid annually as follows:—A, 16.55 per cent, B, 17 per cent, C, 15 per cent and D, 12½ per cent. It is agreed to prorate goodwill among the companies on the ratio of the amount of dividends paid by each during the past five years. It is further agreed that the return of all merchandise sold to, and bought by, one or other of the companies, be accepted and that the full price paid therefor be allowed. The average percentage of net profit on inter-company sales has been A, 20; B, 30; C, 25, D, 35.

The raw materials of D were all bought from C, those of C were bought from B, and those of B from A. A purchased its raw materials in the open market.

The inventories of all companies have been carried on the books at cost

The X Y Company's authorized capital stock is to consist of 2,000,000 shares of no par value. The stockholders of A, B, C and D have agreed to accept 1,500,000 shares, in return for their own stock and holdings of the other companies, which are to be issued at the nominal value of $10 each in payment of their individual interests in the respective companies. Five hundred thousand shares are to be held for sale by the N Banking Company at not less than $10 a share.

The estimated amount of reorganization and financing expenses is $2,000,000 and is to be paid from the proceeds of the sale of the stock held by the banking company. The balance of the proceeds of the sale of the stock is to be turned over to the X Y Company as additional working capital.

From the foregoing, after giving effect to the transactions enumerated, prepare

(1) Balance-sheet of the X Y Company, to submit to the clientele of the N Banking Company for investment purposes.

(2) Statement of the amount of shares of capital stock that will be received by the holders of stock of A, B, C and D respectively.

Problem 95

(New York, October, 1937)

From the following information prepare:

1. Balance-sheet of the ABC Company, June 30, 1937.
2. Profit and loss statement of the ABC Company for the period ended June 30, 1937.
3. Schedule showing number of shares of capital stock to be allotted to the ABC Company and the XYZ Company, respectively, under the consolidation agreement.

The accounts of the ABC Company were audited as of December 31, 1936. The following adjustments were schedulized by the auditors for inclusion in the books of account:

Repairs charged to machinery and equipment in error	$ 4,800
Depreciation allowances for 1936, as follows:	
Buildings, 3% on	69,000
Machinery and equipment, 5% on	150,000

December, 1936, payroll entered on the books in January, 1937:	
Direct labor	$ 6,000
Selling salaries	500
Administrative and general salaries	900
Inventory reduction due to errors	6,500

During the period ended June 30, 1937, additions to fixed assets were made as follows:

Buildings	$ 6,000
Machinery and equipment	50,000

Company ABC agreed to consolidate with Company XYZ, as of July 1, 1937. The new company was to be named the AZ Company.

The accounts of ABC Company again were audited as of June 30, 1937, for the purpose of preparing the necessary balance-sheet as of such date and the profit and loss statement for the new period ended June 30, 1937.

The schedule of adjustments prepared by the auditors as of December 31, 1936, for inclusion upon the records had not been entered thereon, as of June 30, 1937.

The trial balance of the books of the ABC Company, June 30, 1937, was as follows:

Cash	$ 10,000	
Accounts receivable	70,100	
Inventory, December 31, 1936	160,000	
Land	8,000	
Buildings	75,000	
Machinery and equipment	200,000	
Prepaid expenses	500	
Notes payable		$ 100,000
Accounts payable		40,000
Reserve for bad debts		1,000
Reserve for depreciation		47,000
Capital stock (2,500 shares)		250,000
Surplus		155,100
Sales		576,000
Purchases	230,000	
Direct labor	210,000	
Manufacturing expenses	40,000	
Selling expenses	100,000	
Administrative and general expense	58,500	
Nonoperation income		3,000
Nonoperation expense	10,000	
Totals	$1,172,100	$1,172,100

Prepaid and accrued items have not been adjusted as of June 30, 1937:

Unexpired insurance	$ 2,000
Accrued taxes	3,000
The inventory was checked and found to be	239,775
No depreciation has been recorded for the period ended June 30, 1937, although the additions to the fixed assets have been entered correctly. Compute depreciation on gross values as of June 30, 1937.	

The consolidation plan contains the following points of interest:

Preferred capital stock is to be issued to liquidate the notes payable and to provide additional working capital of $150,000.

There are to be 50,000 shares of no-par common capital stock.

The common stock is to be allotted to the two companies as follows:

Five shares for each $100 of net worth.

Balance to be issued in payment for goodwill.

Goodwill is to be determined on the basis of excess average earnings, for the years mentioned below, over a normal return of 10 per cent on the net assets as of June 30, 1937. The fractional share, if any, is to be given to XYZ Company.

The audited earnings of the two companies have been as follows:

Year	Company XYZ	Company ABC
1932	$60,000	$41,504
1933	55,000	41,700
1934	66,500	42,800
1935	66,720	47,772
1936	59,866	52,500
1937 to June 30	34,300	

The balance-sheet of the XYZ Company, agreed upon as acceptable for consolidation purposes, follows:

Assets

Cash	$ 28,100
Accounts receivable (good)	80,500
Inventory	52,750
Plant and equipment	150,500
Prepaid expenses	1,210
Total	$313,060

Liabilities

Accounts payable and accruals	$ 22,740
Reserve for depreciation	16,320
Capital stock (par $100)	60,000
Surplus	214,000
Total	$313,060

Problem 96

(New York, April, 1936)

Using the information presented below and giving consideration to the payments to be made to state and federal authorities, prepare:

1. Blank Company closing entries.
2. Clank Company closing entries.
3. Consolidated Manufacturing Company.
   (*a*) Opening entries.
   (*b*) Opening balance-sheet.

The Blank Company was organized July 1, 1931, under the laws of the state of New York. Its authorized capital stock, all issued and outstanding, was $100,000, divided into 1,000 shares, par value $100 each.

The company operations have been unsuccessful. No dividends have ever been paid on the stock. At present, the capital is impaired. The stockholders duly decided to reorganize A committee was appointed to have the properties appraised and to take whatever measures seem desirable.

The books of account disclose the following information:

Land and buildings	$ 35,000
Machinery and equipment	28,000
Fixtures	14,000
Tools	3,000
Cash	3,200
Notes receivable	17,800
Accounts receivable	87,700
Finished goods	27,500
Raw materials	11,500
Supplies	5,300
Organization expenses	8,000
Organization expenses amortized	3,000
Bonds payable	25,000

Treasury bonds	$ 5,000
Notes payable	26,200
Accounts payable	82,000
Loans payable	26,000
Capital stock	100,000
Treasury stock	5,000

The Clank Company, located upon property adjacent to that of the Blank Company, was organized under the laws of the state of New York five years ago. It has a capital stock of $150,000, authorized, issued and outstanding. This is divided into 1,500 shares, par value $100 each.

The Clank Company has paid a 9 per cent annual dividend since its formation, the yearly net profits being as follows:

1st year	$34,500
2d year	33,000
3d year	35,000
4th year	35,500
5th year	30,500

The Clank Company proposes to the Blank Company committee that the two concerns consolidate, and the proposition is accepted.

The following provisions of the consolidation agreement are of interest:

1. A new company is to be formed, the company name to be Consolidated Manufacturing Company.
2. Blank Company current assets are to be taken over at book value, but a 5 per cent reserve is to be deducted on notes and accounts receivable.
3. The fixed assets are to be taken over as follows:
   a. Land and buildings at 15 per cent over book value.
   b. Machinery and equipment at 85 per cent of book value.
   c. Fixtures at 80 per cent of book value.
   d. Tools at 60 per cent of book value.
4. The Consolidated Manufacturing Company is to assume the Blank Company liabilities to the public. It is to issue to Blank Company capital stock for the excess of assets over liabilities. For any fractional sum of $100, Blank Company is to receive therefor a full $100 share.

5. The assets of Clank Company are to be taken over at their book value. Clank Company is to receive capital stock for its goodwill, this to be 60 per cent of the total of the net profit for the last three years.
6. The Consolidated Manufacturing Company is to put out a $100,000 bond issue with which it is to take up the outstanding bonds of the Blank Company, dollar for dollar. The balance is to be sold to raise cash funds. The stockholders of each respective company have the privilege of taking the bonds at 96. This right is exercised fully.
7. The Consolidated Manufacturing Company is to assume all the Clank Company liabilities to the public.

The following is an accurate list of the balances of the real accounts of the Clank Company as of current date:

Cash	$ 11,740
Notes receivable	8,450
Accounts receivable	74,930
Reserve for notes and accounts	4,169
Finished goods	121,550
Goods in process	8,750
Raw materials	9,840
Land and buildings	20,000
Depreciation reserve	1,000
Machinery and equipment	85,700
Depreciation reserve	8,570
Fixtures	34,900
Depreciation reserve	3,490
Tools (revalued)	6,369
Notes payable	26,500
Accounts payable	87,500
Capital stock	150,000
Surplus	101,000

Problem 97

(American Institute of Accountants, November, 1934)

On December 31, 1928, the Star Drug Company with an outstanding capital of $500,000, the Mormon Drug Company with an outstanding capital of $400,000 and the Gulf Drug Company with an outstanding capital of $450,000—all shares of $100 each —merged into one operating company known as Continental,

Inc., with a capital stock issue of 1,350,000 shares of no par value.

The stockholders of the three merging companies received the 1,350,000 shares in return for their aggregate holdings of $1,350,000 par, i.e., 100 shares of Continental, Inc., for each share of the merging companies. On the above date Continental, Inc., also took over all the assets and liabilities of the three companies. Their individual charters were, however, kept alive.

On December 31, 1933, five years later, the balance-sheet of Continental, Inc., was:

Assets		
Cash		$ 150,000
Accounts receivable:		
Star Drug Co. customers	$ 125,000	
Mormon Drug Co. customers	100,000	
Gulf Drug Co. customers	70,000	295,000
Inventory:		
Star Drug Co. products, materials, etc.	$ 140,000	
Mormon Drug Co. products, materials, etc	120,000	
Gulf Drug Co. products, materials, etc.	115,000	375,000
Plant and equipment at present values appraised on December 31, 1933:		
Star Drug Co. plant	$1,500,000	
Mormon Drug Co. plant	1,300,000	
Gulf Drug Co. plant	1,000,000	3,800,000
Total assets		$4,620,000
Liabilities		
Accounts payable		$ 89,000
Bonds of subsidiary companies:		
Star Drug Company	$1,197,400	
Mormon Drug Company	783,160	
Gulf Drug Company	519,440	2,500,000
Capital stock outstanding		785,000
Surplus		1,246,000
Total liabilities and net worth		$4,620,000

At December 31, 1933, Continental, Inc.'s stockholders decided to decentralize and restore to each of the original companies its proportion of assets and liabilities. The net worth was to be prorated on the basis of each company's capital investment on December 31, 1928, and it was found that the Star Drug Company was to receive 40%, the Mormon Drug Company 36% and the Gulf Drug Company 24%.

On December 31, 1928, the three merging companies owned each other's stock as follows:

The Star Drug Company owned—	
1,200 shares Mormon Drug Co., cost	$ 100,000
2,500 shares Gulf Drug Co., cost	200,000
The Mormon Drug Company owned—	
1,000 shares Gulf Drug Co., cost	75,000
500 shares Star Drug Co., cost	50,000
The Gulf Drug Company owned—	
50 shares Mormon Drug Co., cost	10,000
400 shares Star Drug Co., cost	30,000

A summary of Continental, Inc.'s surplus shows:

Surplus of merging companies—December 31, 1928	
Star Drug Company	$ 190,000
Mormon Drug Company	375,000
Gulf Drug Company	81,000
Excess of par over book value of intercompany holdings	100,000
Earnings of five years	892,500
Total	$1,638,500
Less—Dividends paid	392,500
Balance, December 31, 1933	$1,246,000

It was decided that in the redistribution each of the three companies would receive a proportionate share of the cash; its own accounts receivable and inventory; its original investments in the other companies at original cost to itself and its own plant and equipment. On the other hand, each would assume a proportionate share of the current liabilities but would become wholly liable for its own outstanding bonds. All differences were to be charged or credited to current account for future settlement.

From the foregoing data prepare:

1. A statement showing in columnar form the balance-sheets of the three drug companies after decentralization on December 31, 1933.
2. A statement showing that the adopted ratio 40:36:24 approximately agrees with the proportions existing on December 31, 1928.

Problem 98

(American Institute of Accountants, November, 1933)

On the basis of the following information prepare:

1. An assembly sheet in columnar form to arrive at the figures for the assets and liabilities of the "New Company." No journal entries, formal balance-sheet or work schedules are required.
2. A statement showing the items of which the capital surplus of the "New Company" is composed.

The P Company was an operating and holding company whose position at October 1, 1932, was shown by the following balance-sheet:

Assets	
Cash	$ 150,000
Accounts receivable, less reserve	200,000
Inventories	750,000
Marketable securities—present value	500,000
Investment in subsidiary companies	4,700,000
Fixed assets, less depreciation	8,000,000
Prepaid expenses	50,000
Deficit	1,300,000
Total	$15,650,000
Liabilities	
Accounts payable	$ 300,000
Bank loan	1,000,000
Trade notes payable	170,000
Unpaid bond interest	280,000
First-mortgage 7 % bonds	4,000,000
Eight per cent cum. preferred stock (unpaid dividend $160,000)	2,000,000
Common stock 1,240,000 shares no par	7,900,000
Total	$15,650,000

The P Company had three subsidiaries. It owned the entire capital stock of the "A," the "B" and the "C" companies and all the bonds of the "A" Company. Their balance-sheets at October 1, 1932, were as follows:

Assets	"A" Company	"B" Company	"C" Company
Cash	$ 50,000	$ 20,000	$ 25,000
Accounts receivable, less reserve	10,000	1,000	2,000
Inventories	250,000	150,000	300,000
Land	2,300,000	1,400,000	1,000,000
Buildings, plant and equipment	700,000	350,000	200,000
Prepaid expenses	20,000	2,000	4,000
Deficit	200,000	70,000	120,000
Totals	$3,530,000	$1,993,000	$1,651,000

Liabilities	"A" Company	"B" Company	"C" Company
Accounts payable	$ 30,000	$ 10,000	$ 15,000
Notes payable	50,000		100,000
Unpaid bond interest		90,000	48,000
First-mortgage 6% gold bonds	1,800,000	1,000,000	800,000
Reserve for depreciation	150,000	93,000	88,000
Capital stock, $100 par	1,500,000	800,000	600,000
Totals	$3,530,000	$1,993,000	$1,651,000

Each of the four mortgages covered land, building, plant and equipment but none of the other assets.

The P Company and its subsidiaries—excepting the A Company—had defaulted on mortgage interest and the P Company had not paid its preferred-stock dividends for the last four quarters. The outside holders of the several securities formed protective committees, and to forestall a receivership a reorganization committee was appointed to outline a rehabilitation plan. Under this plan the outside holders deposited their securities with a trustee. However, the bondholders of the C Company withdrew from the plan and foreclosed their mortgage. They recovered their claim in full, but nothing was left over.

The finally accepted reorganization scheme provided for the formation of a "New" company with 1,000,000 shares no-par-value stock to be set up at $5 per share. Parts of this stock was to be issued in exchange for the deposited securities as follows:

Holders of P Company bonds were to get 175 shares and those of B Company bonds 130 shares for each $1,000 bonds including unpaid interest.

Holders of P Company preferred stock were to get 6 shares for each share of $100 par value including unpaid dividend.

To procure additional working capital $5,000,000 new 7% first-mortgage bonds were authorized, of which $2,500,000 were

to be issued at 90. A bonus of 10 shares of the new stock was to go with each $200 of new bonds.

The creditor bank agreed to underwrite the above issue subject to the rights of old and new bond and stockholders and provided that the loan of $1,000,000 be paid out of the proceeds. The remainder of the capital stock was to be issued later in accordance with subscription rights given to the common stockholders.

The three sub-companies were dissolved and the New Company took over the assets and assumed the liabilities of the old companies in accordance with the plan and subject to the foreclosure on the C Company property. Fixed assets with relative depreciation were taken over at 50% of book value and the A Company mortgage was cancelled by the P Company. A reserve of $500,000 was set up for contingencies, such as loss on inventories, etc. Reorganization expenses were $100,000.

Problem 99

(American Institute of Accountants, May, 1935)

The Eastern Company, the Southern Company, and the Western Company are consolidated by the following method:

1. A new corporation, the Northern Company, is formed.
2. The Northern Company takes over all the assets and assumes all the liabilities of the three consolidating companies, paying for them as follows: To the preferred stockholders of the old companies, first-mortgage bonds of the new company at par. The total authorized bond issue is $400,000.

   To the holders of common stock:

   In the Eastern Company—30 shares of new stock for each share of old stock.

   In the Southern Company—10 shares of new stock for each share of old stock.

   In the Western Company—20 shares of new stock for each share of old stock.

3. The new company (the Northern Company) is capitalized at $1,000,000. (100,000 shares of a par value of $10 each.)

4. All properties are to be taken over at their book values.
5. The old companies are to be dissolved.

On the date of consolidation the balance-sheets of the three combining companies were as follows:

Assets	Eastern Company	Southern Company	Western Company
Land	$ 600,000	$ 30,000	$ 20,000
Buildings	20,000	100,000	25,000
Machinery and equipment	250,000	125,000	10,000
Inventories	75,000	100,000	20,000
Notes receivable	10,000		
Accounts receivable	165,000	325,000	160,000
Cash	30,500	35,000	15,000
Prepaid insurance, etc	2,500	1,500	500
Totals	$1,153,000	$716,500	$250,500
Liabilities and Net Worth			
Preferred stock—par $100	$ 300,000	$ 50,000	$ 50,000
Common stock—par $100	200,000	300,000	50,000
Notes payable	50,000	50,000	
Accounts payable	69,000	158,500	70,500
Accrued taxes	5,000	3,000	1,000
Unpaid wages	20,000	10,000	2,000
Reserve for depreciation:			
Building	4,000	20,000	5,000
Machinery and equipment	30,000	45,000	2,000
Surplus	475,000	80,000	70,000
Totals	$1,153,000	$716,500	$250,500

The Western Company owed the Southern Company $24,000 on open account.

The $10,000 notes receivable of the Eastern Company represent notes of the Southern Company.

Prepare the balance-sheet of the Northern Company after the consolidation has been effected.

Problem 100

(Ohio, May, 1934)

The X Corporation, a holding company, owned as of December 31, 1932, 3,000 shares of stock in A Company, 4,000 shares each in companies B and C. The X Corporation had advanced cash to these companies, and as of December 31, 1932, there was

accrued interest on the balances due amounting to 5 per cent per annum from June 30, 1932, the last settlement date.

Companies A, B and C were consolidated as of January 1, 1933, and stock of the new Consolidated Company issued at $20 per share in exchange for the entire capital of each of the companies as follows:

A Company	11,250 shares
B Company	24,000 shares
C Company	14,000 shares

Any differences between the adjusted book value of the old stocks and the issuing price of the new stock were settled in cash. The X Corporation purchased 10,750 shares, at $20 per share, of the new issue and settled in cash after receiving credit for amounts owing to it by subsidiary companies.

Balance-sheets as of December 31, 1932

Assets	A	B	C
Cash	$ 40,000	$ 68,000	$ 24,000
Accounts receivable	40,000	240,000	92,000
Inventories	65,000	60,000	98,000
Advances to B Company	40,000		
Investments—at cost:			
Company C—3,000 shares	60,000		
Treasury Stock—1,000 shares			15,000
(acquired July 3, 1932)			
Land	10,000	15,000	10,000
Buildings and equipment	120,000	300,000	175,000
(net after deducting depreciation)			
Discount on bonds payable		5,000	
Totals	$375.000	$688,000	$414,000
Liabilities			
Accounts payable	$ 28,750	$ 68,500	$ 50,500
Advances—X Corporation	50,000	20,000	60,000
Dividends payable			
($1 per share)			8,000
Bonds payable, 6%		100,000	
Accrued interest, December 31, 1932		3,000	
Net worth			
Capital stock—stated value			
5,000 Shares no-par common	250,000		
8,000 Shares no-par common		400,000	
8,000 Shares no-par common			200,000
Surplus account	46,250	96,500	95,500
Totals	$375,000	$688,000	$414,000

Statement of surplus accounts

	A	B	C
Balance, December 31, 1931	$ 8,250	$11,500	$111,500
Paid in surplus	25,000		
Reserve for contingencies created in 1930.		20,000	
Appraisal of buildings and equipment, December 31, 1931		50,000	
Dividends received on stock of Company C	3,000		
Dividends paid, July 3, 1932 (to stockholders of record June 30, 1932)			8,000
Transfer to capital stock to increase stated value from $20 to $25 on 4,000 shares sold at $20 per share			20,000
Dividend declared on stock of record, December 31, 1932			8,000
Net profits, 1932	10,000	15,000	20,000
Balance, December 31, 1932	$ 46,250	$ 96,500	$ 95,500

Accrued interest on advance by A Company to B Company was $1,000 as of December 31, 1932.

The bonds payable of the B Company were refunded by the Consolidated Company as of January 1, 1933, with a new issue of 5s due 1943 exchanged at 94, the difference being settled in cash. The discount on the old issue was canceled prior to consolidation by B Company.

You are to prepare:

1. Consolidated balance-sheet and surplus account of Companies A, B and C, showing the equitable interest of stockholders as of December 31, 1932.
2. Balance-sheet of the Consolidated Company as of January 1, 1933, after giving effect to all cash settlements and the refunding of bonds as outlined.
3. (*a*) Statement showing the book value per share of The X Corporation's holdings in the subsidiary companies before consolidation and the net earnings per share for the year 1932. (*b*) The X Corporation's total investment in the Consolidated Company as of January 1, 1933.

SECTION XV

CONSOLIDATED STATEMENTS

Problem 101

(Ohio, November, 1931)

The T. Y. C. Company was formed on January 1, 1929, at which time it sold its authorized capital stock of $50,000 at par. On January 1, 1929, it purchased the following:

Municipal bonds (purchased at par)	$10,000	Interest payable January and July 1
Land (subject to pavement tax)	5,000	
Buildings	15,000	Depreciation rate 3%
Fixtures	2,000	Depreciation rate 10%

The following transactions occurred subsequently:

	1929	1930
Merchandise purchases (usual credit terms)	$100,000	$100,000
Cash and cash discounts applied on purchases	90,000	85,000
Merchandise sales (usual credit terms)	160,000	140,000
Cash and cash discounts applied on sales	150,000	142,500
Notes received for sales	5,000	
Cash discounts allowed (financial expense)	2%	2%
Cash discounts earned (financial income)	2%	2%
Interest received on bonds (cash received)	425	425
Donations (cash paid)	500	330
Pavement tax (cash paid)	2,000	
1929 federal income tax (cash paid)		1,650
Commercial expenses (cash paid)	60,150	59,200

At the close of 1929, the company engaged an accountant, who correctly prepared their 1929 income-tax return (tax rate 11 per cent, exemption $3,000) but did not place the closing entries upon the books.

On January 1, 1930, another corporation purchased 80 per cent of The T. Y. C. Company's capital stock, paying $55,000

for it, and on January 1, 1931, purchased an additional 10 per cent for $8,000.

The merchandise purchases during 1930 were acquired from the company holding its stock and included a profit to them of $10,000.

The federal income-tax rate for 1930 was 12 per cent with an exemption of $3,000 and the same rate of gross profit obtained in 1930 as in 1929.

Required of candidate:

Work sheet in good form.
Journal entries for purchasing company.
Statement of minority interests after consolidation, subsequent to purchase on January 1, 1931.

Problem 102

(American Institute of Accountants, November, 1936)

On January 1, 1930, the X Manufacturing Company acquired for $1,000,000 in cash all the capital stock of the Y Coal Company. On that date the balance-sheet of the Y Coal Company was as follows:

Assets	
Coal lands, less depletion	$400,000
Other assets (Valued in accordance with the accounting practice followed by both companies)	300,000
Total	$700,000
Liabilities	
Liabilities	$100,000
Capital stock	500,000
Surplus	100,000
Total	$700,000

The operations of the Y Coal Company are confined to the mining of coal for the exclusive use of the X Manufacturing Company. No inventories of coal are carried by the Y Coal Company, as all coal mined is immediately charged to the X M[illegible] Company at a profit of 50 cents a ton after charging 10 cents a ton to the mining cost for depletion.

The books of the two companies are kept on the same accounting basis but independent of each other and without regard to the requirements of possible consolidation of the balance-sheets. On December 31, 1935, such a consolidation was contemplated for the first time, and on that date the balance-sheet of the Y Coal Company was as follows:

Assets	
Coal lands, less depletion	$300,000
Amount due from "X Co."	200,000
Other assets	250,000
Total	$750,000
Liabilities	
Liabilities	$100,000
Capital stock	500,000
Surplus	150,000
Total	$750,000

Depletion provided by the Y Company was based on the cost of the coal lands to "Y" at the date of acquisition ($500,000) and the estimated number of tons of coal in the lands (5,000,000). The estimated number of tons of coal in the lands at January 1, 1930, was 4,000,000. Between that date and December 31, 1935, 1,000,000 tons were mined. No coal lands were purchased or sold by the Y Company since the date of acquisition and no dividends were ever paid by the Y Company.

The investment by the X Company in the Y Company was carried at December 31, 1935, at cost to the X Company ($1,000,000). On that date the accounts of X Company showed that an amount of $150,000 was due to the Y Company and the difference between this amount and the amount of $200,000 shown as receivable by the Y Company was accounted for as follows:

Cash in transit	$40,000
Inventory in transit (5,000 tons at $2.00)	10,000
Total	$50,000

The inventory of the X Company contains 5,000 tons of coal (exclusive of the 5,000 tons in transit) at $2 a ton, plus transportation cost, which includes the profit of 50 cents a ton (already mentioned) to the Y Company.

There are no intercompany accounts, relations or transactions other than those indicated in this problem.

The accounts of the Y Company are not to be changed, and all adjustments required for a ready consolidation of the balance-sheets of the two companies are to be made on the X Company's books.

Prepare entries for these adjustments.

Problem 103

(American Institute of Accountants, November, 1937)

From the following data prepare:

a. Consolidation working-sheet, showing eliminations and adjustments
b. Final consolidated balance-sheet
c. Schedule of dividends in arrears showing amounts applicable to minority interests.

The date on which A acquired capital stock of subsidiary companies was, in each case, the date on which the subsidiary company was organized.

A Company:	
Investment in B Company:	
Common stock 800 shs, 80 pct. int.	$ 80,000
Preferred stock 400 shs, 40 pct. int	40,000
Investment in C Company:	
Common stock 600 shs, 60 pct. int.	60,000
Reserve against investment in C Company	59,999
Investment in D Company:	
Common stock 1,000 shs, 2/3 int.	100,000
Preferred stock 800 shs, 80 pct. int.	80,000
Investment in E Company:	
Common stock 1,900 shs, 95 pct. int.	190,000
2nd preferred stock 400 shs, 80 pct. int.	40,000
Account receivable, C Company	300,000
Other assets	69,999
Capital stock	500,000
Earned surplus	400,000
B Company:	
Assets	350,000
Preferred stock, 6 pct. noncumulative	100,000
Common stock	100,000
Earned surplus	150,000

C Company:	
Assets	$420,000
Account payable A Company	300,000
Account payable, minority stockholders	200,000
Common stock	100,000
Deficit	180,000
D Company:	
Assets	244,000
Preferred stock, 6 pct. cumulative	100,000
Common stock	150,000
Deficit	6,000
E Company:	
Assets	155,000
1st preferred stock, 6 pct. cumulative	100,000
2nd preferred stock, 6 pct. cumulative	50,000
Common stock	200,000
Deficit	195,000

All the subsidiary companies made a loss during the current year except B Company, which made a profit of $10,000.

Dividends have not been paid on preferred stocks outstanding as follows:

B—for 1 year
D—for 4½ years
E—1st preferred for 1½ years
—2nd preferred for 4 years

The preferred stocks of each subsidiary are callable upon 30 days' notice at $110 per share plus accrued dividends and are entitled upon liquidation to $100 per share plus accrued dividends.

Problem 104

(American Institute of Accountants, May, 1934)

The Mammoth Company has owned a controlling interest in the Glendale Company since the latter company's organization on January 1, 1920, and in its annual published accounts has shown this interest as a single item under "investments." On January 1, 1933, in continuance of its policy to buy up all available outstanding capital stock and debentures of the Glendale Company, the Mammoth Company acquired an additional 53 shares of preferred stock for $2,190. On July 1, 1933, the latter

company purchased $23,000 par value of debentures for $20,000 and returned to the Glendale Company for retirement $5,000 par value of debentures. The following statement shows particulars of the Mammoth Company's book record of its interest on December 31, 1933 and 1932.

Investment in and advances to Glendale Company

	December 31, 1933		December 31, 1932	
	Owned	Carried at	Owned	Carried at
Common stock at cost, January 1, 1920, less $980,000 written off to operations	19,900 shares	$ 15,000	19,900 shares	$ 15,000
Preferred stock at cost	14,053 "	602,190	14,000 "	600,000
Debentures at cost	$ 78,000 par	76,000	$ 60,000 par	61,000
Totals		$ 693,190		$ 676,000
Current account	$5,150,000		$5,275,000	
Less—Written off to operations	4,125,000	1,025,000	4,125,000	1,150,000
Totals		$1,718,190		$1,826,000

The directors of the Mammoth Company have decided that on December 31, 1933, instead of showing the investment in and advances to Glendale Company as a single item in the Mammoth Company's balance-sheet, the assets and liabilities of the Glendale Company shall be included with those of the Mammoth Company, according to their character, as current assets, fixed assets, debentures or otherwise. As auditor of the Mammoth Company you are in complete accord with this procedure, but you can not accept without verification the following figures which have been included in the consolidation of December 31, 1933, and are presented as being taken from the Glendale Company's balance-sheet of that date.

Current assets	$ 692,100
Fixed assets	3,098,500
Total	$3,790,600
Current liabilities	$ 159,600
Debentures due January 1, 1950	650,000
Earned surplus	1,155,000
Total	$1,964,600

In support of the above figures the balance-sheets of the Glendale Company are submitted as shown in the table on page 213.

	December 31 1933	December 31 1932
Current assets	$ 692,100	$ 236,500
Fixed assets, less depreciation	3,098,500	3,698,500
Total	$3,790,600	$3,935,000
Current liabilities	$ 159,600	$ 64,000
Debentures outstanding, due January 1, 1950	650,000	700,000
Due to Mammoth Company	7,519,000	7,240,000
Capital stock:		
Common—20,000 shares of $50 each	1,000,000	1,000,000
Preferred—16,000 shares of $50 each	800,000	800,000
Deficit from operations	*6,338,000*	*5,869,000*
Total	$3,790,600	$3,935,000

In the course of your examination you have ascertained:

(1) That up to and including December 31, 1932, the Glendale Company has credited $1,965,000 interest to its account with the Mammoth Company but that the Mammoth Company has not taken up this interest.

(2) That no depreciation has been provided by the Glendale Company for the period from January 1, 1920, to December 31, 1932, :.' '· .:' it is agreed that depreciation of $100,000 per annum should have been provided.

(3) That the net loss of the Glendale Company for the year ended December 31, 1933, is $469,000, after charging $600,000 for depreciation, $404,000 for interest on current account with the Mammoth Company and $40,500 for interest on debentures.

(4) That the write-offs on the Mammoth Company's books were intended to reduce the investment to its share of the book value of the Glendale Company's net assets, less depreciation on fixed assets at the rate of $100,000 per annum.

You are required to submit:

1. A December 31, 1933, balance-sheet of the Glendale Company prepared for ready consolidation with the Mammoth Company's balance-sheet of that date.
2. The investment, current and other accounts on the Mammoth Company's books with the adjustments and changes that will make the record clearer and bring it into agreement with the facts disclosed by the adjusted Glendale Company's books on December 31, 1933.

Problem 105

(Ohio, October, 1930)

Certain promoters desire to acquire a substantial stock interest in companies X, Y and Z and propose to organize Company A with such number of shares of capital stock as you may consider reasonable and necessary for the purpose. Preferred shares shall have a par value of $100, and common shares shall have no par value. The audited balance-sheets of companies X, Y and Z are submitted to you with the following information:

At the date of the balance-sheets, Company X owes Y $5,000; Y owes Z $5,000; and Z owes X $5,000.

It is proposed that Company A will acquire the following shares from individual owners:

$125,000 par value X common
$100,000 par value Y common
$ 70,000 par value Z common
Also the stock of Z owned by Company Y

Company A will pay for these shares in preferred stock at par in an amount equal to their respective values after adjusting permanent assets and goodwill to the independent appraisals shown below:

	Permanent assets	Goodwill
Company X	$ 48,000	$280,000
Company Y	190,000	110,000
Company Z	33,000	10,000

Company A has also agreed to give one share of its common stock with each five shares of preferred stock issued in connection with this transaction.

It is expected that ultimately Company A will also acquire the remaining shares of companies X, Y and Z for the same consideration, and you are requested to include in your capital sufficient shares for this purpose.

Company A, immediately after organization, will sell 4,000 shares of preferred stock at $90 a share to finance construction of a new plant, for which purpose the proceeds are specifically dedicated.

The promoters will pay all organization expenses and will receive from Company A an option to purchase within six months 1,350 shares of common stock at $50 a share.

The promoters, who are financially responsible, agree to purchase at any time within six months any stock of Company A offered to them on the basis of $90 a share for preferred and $50 a share for common.

You are requested to prepare a consolidated balance-sheet of Company A, giving effect to all transactions to be presently consummated, clearly exhibiting the interest of minority stockholders. You are to submit journal entries and such working papers as will show in what manner your results have been obtained.

	Companies		
	X	Y	Z
Assets			
Cash	$ 10,000	$ 50,000	$ 250
Accounts receivable	29,500	7,500	10,000
Inventory	100,000	92,575	21,600
Sinking-fund assets	12,000		
Stock of X at par		50,000	
Stock of Z at par		10,000	
Stock of X at cost (par value $6,000)			7,500
Bonds of X at par		25,000	
Permanent assets	40,000	200,000	30,000
Goodwill	200,000	130,000	25,000
Deferred charges	500	925	50
Deficit			8,620
Totals	$392,000	$566,000	$103,020
Liabilities			
Accounts payable	$ 26,000	$ 60,000	$ 23,020
Dividend declared	4,000		
Bonds	50,000	200,000	
Sinking fund	12,000		
Capital stock (common)	200,000	150,000	80,000
Preferred stock		100,000	
Surplus	100,000	56,000	
Totals	$392,000	$566,000	$103,020

Problem 106

(American Institute of Accountants, May, 1936)

From the following data prepare a consolidated balance-sheet of the Alpha Company and subsidiaries as at December 31, 1934:

	December 31, 1934		
	Alpha Co.	Beta Co.	Gamma Co.
Cash in banks and on hand	$ 30,000	$ 10,000	$ 15,000
Customers' notes and accounts receivable	90,000	50,000	60,000
Inventories	70,000	60,000	50,000
Investments at cost			
Stock of Beta Company—75%	100,000		
" " Gamma " —80%	200,000		
Property, plant and equipment, less reserve for depreciation	500,000	200,000	120,000
Investment at cost			
Stock of Beta Company—15%			30,000
Deferred charges	10,000	5,000	5,000
Totals	$1,000,000	$325,000	$280,000
Notes payable	$ 60,000	$ 50,000	$ 30,000
Accounts payable	40,000	45,000	20,000
Mortgage on plant			90,000
Capital stock—par value $100 a share	500,000	200,000	100,000
Surplus	400,000	30,000	40,000
Totals	$1,000,000	$325,000	$280,000
Surplus:			
Earned surplus at December 31, 1933	$ 280,000	$ 10,000	$ 50,000
Income for year 1934	70,000	20,000	30,000
Increase on appraisal of land as at January 1, 1934	100,000		
Totals	$ 450,000	$ 30,000	$ 80,000
Dividends paid	50,000		40,000
Surplus at December 31, 1934	$ 400,000	$ 30,000	$ 40,000

The Alpha Company acquired its holdings in "Beta" and "Gamma" on December 31, 1933.

The Gamma Company's holding of Beta Company stock was purchased at an earlier date at par, which was also the book value.

Problem 107

(American Institute of Accountants, May, 1930)

Following are the balance-sheets of companies M and N as at December 31, 1929:

COMPANY M

Assets

Current:		
Cash		$ 50,000
Accounts receivable—customers		800,000
" " —N company		100,000
Inventories		480,000
Total current assets		$1,430,000
Fixed—less reserve for depreciation		3,500,000
Investment in N Company		800,000
(Cost of 3,800 shares of preferred and 23,520 shares of common stock, acquired July 1, 1929)		
Prepaid expenses		20,000
Goodwill		1,000,000
Total assets		$6,750,000

Liabilities

Current:		
Notes payable		$ 400,000
Accounts "		200,000
Dividends "		105,000
Accruals		45,000
Total current liabilities		$ 750,000
Funded debt:		
First-mortgage bonds		2,000,000
Capital stock:		
Preferred—6 per cent cumulative, 10,000 shares of $100 each	$1,000,000	
Common—30,000 shares, no par value	2,500,000	
Total capital stock		3,500,000
Surplus		500,000
Total liabilities and net worth		$6,750,000

COMPANY N

Assets

Current:		
Cash		$ 15,000
Accounts receivable—customers		300,000
Inventories		150,000
Total current assets		$ 465,000
Fixed—less reserve for depreciation		800,000
Prepaid expenses		5,000
Goodwill		250,000
Total assets		$1,520,000

Liabilities

Current:		
Notes payable		$ 100,000
Accounts "		150,000
Dividends "		29,000
Accruals		21,000
Total current liabilities		$ 300,000
Funded debt:		
Serial gold notes		400,000
Capital stock:		
Preferred—4,000 shares, no par value; cumulative dividends of $5 per share, per annum	$ 300,000	
Common—24,000 shares, no par value	400,000	
Total capital stock		700,000
Surplus		120,000
Total liabilities and net worth		$1,520,000

Particulars of the surplus accounts of the respective companies are shown as follows:

COMPANY M

1929			
Jan. 1	Balance		$345,250
Mar. 31	Preferred dividends, March quarter	$ 15,000	
June 30	Net income for the half year		120,000
	Dividends—preferred, June quarter	15,000	
	" —common, half year	90,000	
Sept. 30	Preferred dividend, September quarter	15,000	
Oct. 15	Dividend received on N company preferred stock for quarter ended September 30th		4,750
Dec. 31	Net income for the half year		270,000
	Dividends—preferred, December quarter	15,000	
	" —common, half year	90,000	
	Balance down	500,000	
	Totals	$740,000	$740,000
1930			
Jan. 1	Balance		$500,000

COMPANY N

1929			
Jan. 1	Balance		$ 44,000
Mar. 31	Preferred dividend, March quarter	$ 5,000	
June 30	Net loss for the half year	50,000	
	Preferred dividend, June quarter	5,000	
Sept. 30	" " September quarter	5,000	
Dec. 15	Increase on appraisal of fixed assets		90,000
31	Net income for the half year		80,000
	Dividends—preferred, December quarter	5,000	
	" —common stock	24,000	
	Balance down	120,000	
	Totals	$214,000	$214,000
1930			
Jan. 1	Balance		$120,000

From the foregoing, you are required to prepare a consolidated balance-sheet, as at December 31, 1929.

Problem 108

(American Institute of Accountants, May, 1931)

From the data following, prepare the journal entries necessary properly to adjust the accounts for the purpose of consolidation and submit a consolidated balance-sheet, together with working papers.

The results of examinations of the books of the Kerry Dairy Company and its subsidiaries, as of June 30, 1929, were shown as follows:

Assets	Kerry Dairy Co.	City Creamery	Watson & Roan, Inc.	Newport Dairy Co.
Cash	$ 7,500	$ 4,500	$ 8,000	$ 1,500
Notes receivable	10,000		5,000	2,000
Accounts receivable	24,000	10,000	17,500	6,800
Merchandise inventories	15,000	8,000	13,000	4,000
Investments:				
City Creamery	28,000			
Watson & Roan, Inc	52,000			
Newport Dairy Co	30,000			
Land	11,500		7,000	
Buildings	26,000		28,000	
Plant equipment	34,000	25,000	35,000	42,000
Delivery equipment	8,000	3,000	9,000	7,000
Deficit				2,400
Totals	$246,000	$50,500	$122,500	$65,700
Liabilities				
Notes payable	$ 15,000	$ 7,500	$ 10,000	$12,000
Accounts payable	20,000	6,200	2,700	4,200
Bonds payable	40,000		20,000	
Reserves for depreciation	35,000	6,000	18,600	9,500
Capital stock	125,000	25,000	65,000	40,000
Surplus	11,000	5,800	6,200	
Totals	$246,000	$50,500	$122,500	$65,700

During the course of the audit, the following facts were discovered:

The holding company purchased 90 per cent of the capital stock of the City Creamery, July 1, 1926; 80 per cent of that of Watson & Roan, Inc., July 1, 1925, and 75 per cent of that of the Newport Dairy Co., July 1, 1927, when this company was organized.

The investment in the City Creamery was arbitrarily increased on the books of the holding company in 1929 by a charge thereto and a credit to surplus of $2,000. Except for this entry, the book value of the investment represented cost. The investment in the Newport Dairy Co. was also carried at cost. The holding company had, however, taken up its share of the profits and losses of Watson & Roan, Inc., through the investment account.

An analysis of the surplus accounts of the subsidiary companies was as follows:

	City Creamery	Watson & Roan, Inc.	Newport Dairy Co.
Balance—June 30, 1925		$15,200	
Profit—1925–1926		2,500	
Balance—June 30, 1926	$3,500	17,700	
Profit—1926–1927	2,400*	8,000*	
Balance—June 30, 1927	1,100	9,700	
Profit—1927–1928	1,500	2,700*	$1,500*
Balance—June 30, 1928	2,600	7,000	1,500*
Profit—1928–1929	3,200	800*	900*
Balance—June 30, 1929	$5,800	$ 6,200	$2,400*

* Representing loss.

The intercompany accounts were as follows:

On the books of	Kerry Dairy Co.	City Creamery	Watson & Roan, Inc.	Newport Dairy Co.
Notes receivable—				
Kerry Dairy Co.		$2,000	$3,000	$5,000
Watson & Roan, Inc.				3,000
Notes payable—				
City Creamery	$2,000			
Watson & Roan, Inc.	3,000			
Newport Dairy Co.	5,000		3,000	
Accounts receivable—				
Kerry Dairy Co.		2,400	1,700	1,800
City Creamery				700
Accounts payable—				
City Creamery	2,200			
Watson & Roan, Inc.	1,600			
Newport Dairy Co.	1,500		600	

The inventories of the subsidiary companies contain goods purchased from the holding company on which the latter made a profit of 10 per cent, viz., City Creamery $3,000, and Watson & Roan, Inc., $1,200.

In June, 1929, the Newport Dairy Co. purchased plant equipment from Watson & Roan, Inc., and paid $12,000 therefor. The cost to Watson & Roan, Inc. (less depreciation) was $10,000.

The differences in intercompany accounts represent remittances in transit at the date of closing.

Problem 109

(New York, October, 1933)

The Smythe Investment Company has bought the control of B Company, X Company and D Company as of June 30, 1931.

You are requested to prepare a consolidated balance-sheet of these four companies at the end of the first year, June 30, 1932.

You have the following balance-sheets of the four companies:

Assets	B Company	X Company	D Company	Smythe Investment Company
Cash in banks	$ 8,000	$ 1,000	$ 5,000	$ 9,000
Inventories	22,000	12,000	5,000	
Accounts receivable	10,000	4,000	10,000	
Properties	100,000	30,000	40,000	
Investments:				
B Company (70% cost $105,000)				120,000
X Company (60% at cost)				24,000
D Company (80% at cost)				32,000
Other				19,500
Advances to B Company				15,000
Advances to D Company				10,000
Totals	$140,000	$47,000	$60,000	$229,500
Liabilities				
Capital stock	$100,000	$40,000	$40,000	$200,000
Smythe Investment Company	15,000		10,000	
Surplus	25,000	7,000	10,000	29,500
Totals	$140,000	$47,000	$60,000	$229,500

An analysis of the surplus accounts is as follows:

	B Company	X Company	D Company	Smythe Investment Company
Balance, June 30, 1931	$20,000	$ 500	$ 5,000	$12,000
Net income:				
Six months to December 31, 1931	13,000	6,400	3,700	
Six months to June 30, 1932	17,000	10,100	1,300	22,500
Increase in value of B Company stock				15,000
Totals	$50,000	$17,000	$10,000	$49,500
Dividends paid, February, 1932	25,000	10,000		20,000
Balance, June 30, 1932	$25,000	$ 7,000	$10,000	$29,500

Your investigation discloses the following, which should be used in the preparation of your consolidated balance-sheet:

1. The following journal entry was put on the books of the Smythe Investment Company at June 30, 1932, and was in accord with a resolution of the Board of Directors, dated June 15, 1932.

Investment in B Company stock	$15,000	
Surplus		$15,000

2. Some machinery on the books of the D Company was built by the B Company in the fall of 1931 at a cost of $10,000. For this work the B Company charged the D Company $15,000.
3. Merchandise purchased from the X Company is included in the B Company inventory at $5,000. The cost of these goods to the X Company was $4,500.
4. Intercompany interest is to be accrued at 5 per cent, and it is assumed that the advances were made January 1, 1932.
5. In the spring of 1932, equipment carried on the X Company's books at $8,000 was destroyed by fire. The only entry on the books in reference to this was to credit the property account with salvage of $300.

Problem 110

(American Institute of Accountants, May, 1934)

From the following balance-sheets and income accounts of the Universal Machinery Company and its Canadian subsidiary company prepare a consolidated balance-sheet and income account and submit the working papers relative thereto:

UNIVERSAL MACHINERY COMPANY
Balance-sheet, December 31, 1932
Assets

Land		$ 130,000
Buildings and equipment		400,000
Investment in Universal Machinery Company of Canada, Ltd.		200,000
Advances to Universal Machinery Company of Canada, Ltd.		30,000
Investment in stock of Universal Machinery Company—500 shares at cost		10,000
Inventories		260,000
Accounts receivable		240,000
Cash		150,000
Deferred charges		25,000
Total		$1,445,000

Liabilities

Capital stock:		
Common, no par value, 10,000 shares outstanding		$1,000,000
Reserves for depreciation		110,000
Accounts payable		185,000
Total		$1,295,000
Surplus:		
Balance January 1, 1932	$140,000	
Net profit for year	70,000	
Total	$210,000	
Dividend paid—$6 a share	60,000	
Balance December 31, 1932		150,000
Total		$1,445,000

UNIVERSAL MACHINERY COMPANY OF CANADA, LTD.
Balance-sheet, December 31, 1932
(Accounts stated in Canadian currency)
Assets

Land	$ 55,000
Buildings and equipment	130,000
Inventories	80,000
Accounts receivable	60,000
Cash	50,000
Deferred charges	5,000
Total	$380,000

Liabilities

Capital stock:	
Common, $100 par value, 2,000 shares outstanding	$200,000
Reserves for depreciation	30,000
Accounts payable	50,000
Universal Machinery Company—advances	30,000
Total	$310,000

Surplus:		
Balance January 1, 1932	$100,000	
Net profit for year	20,000	
Total	$120,000	
Dividend paid	50,000	
Balance December 31, 1932		$ 70,000
Total		$380,000

Income account for the year 1932

	Universal Machinery Company	Universal Machinery Company of Canada, Ltd.
Net profit from operations	$47,000	$25,000
Depreciation at 5% of buildings and equipment at January 1, 1932	20,000	5,000
Totals	$27,000	$20,000
Miscellaneous income:		
Dividend received from Universal Machinery Company of Canada, Ltd.	$50,000	
Dividend on Universal Machinery Company stock held as an investment	3,000	
Total	$53,000	
Total	$80,000	
Provision for federal income taxes	10,000	
Net profit for year	$70,000	$20,000

(1) The Canadian dollar was quoted at 90 cents on December 31, 1932, and at par on January 1, 1932. The average rate for the year was 95 cents.
(2) The investment of the Universal Machinery Company in the real estate, plant and equipment of the Canadian company at January 1, 1932, amounted to $155,000 United States currency.
(3) Additions to the real estate and plant of the Canadian company during 1932 amounted to $30,000 Canadian currency.
(4) The question of income taxes need not be further considered.

Problem 111

(Pennsylvania, November, 1935)

You have completed an audit as of June 30, 1935, of the Temple Candy Company and its subsidiaries. From the following data that you have gathered, prepare a work sheet showing the adjustment of the various accounts for the purpose of consolidation, and also submit a consolidated balance-sheet.

Balance-sheets, June 30, 1935

Assets	Temple Candy Company	Sweets Candy Company	Candy Shops, Inc.
Cash	$ 10,000	$ 6,000	$ 2,500
Notes receivable	7,000	3,000	
Accounts receivable	36,000	15,000	7,500
Merchandise inventories	20,000	10,000	5,000
Investments:			
Sweets Candy Company	30,000		
Candy Shops, Inc	28,000		
Land	18,000		5,000
Buildings, plant and equipment	76,000	35,000	35,000
Deficit			4,000
Total	$225,000	$69,000	$59,000
Liabilities and capital			
Notes payable	$ 12,000	$ 6,000	$ 8,000
Accounts payable	18,000	7,500	9,000
Bonds payable	50,000	15,000	
Reserves for depreciation	25,000	9,000	7,000
Capital stock	100,000	25,000	35,000
Surplus	20,000	6,500	
Total	$225,000	$69,000	$59,000

The holding company acquired 90 per cent of the capital stock of the Sweets Candy Company July 1, 1932, at a cost of $28,000 and later arbitrarily increased the book value of this asset to $30,000, crediting the increase to surplus. Eighty per cent of the capital stock of Candy Shops, Inc., was acquired at a cost of $28,000 when that company was organized, July 1, 1933.

In June, 1935, Candy Shops, Inc., sold to the Sweets Candy Company for $1,000 cash plant equipment which cost the former company (after depreciation) $500.

The intercompany accounts at June 30, 1935 were as follows: The Temple Candy Company held notes of the Sweets Candy Company for $3,000 and the Candy Shops, Inc., for $4,000.

The Sweets Candy Company held a note of the Candy Shops, Inc., for $3,000.

The Temple Company owed on open account to the Sweets Candy Company, $4,000 and to the Candy Shops, Inc., $2,500.

The inventories of the subsidiary companies contain goods, viz., the Sweets Candy Company $3,000 and the Candy Shops, Inc., $1,000, purchased from the holding company on which the latter made a profit of 10 per cent.

The surplus accounts of the subsidiary companies, analyzed, were as follows:

	Sweets Candy Company	Candy Shops, Inc.
Balance, July 1, 1932	$4,000	
Profit, 1932–1933	3,000	
Balance, July 1, 1933	$7,000	
Profit or loss, 1933–1934	1,500*	$5,000*
Balance, July 1, 1934	$5,500	$5,000*
Profit or Loss, 1934–1935	1,000	1,000
Balance, June 30, 1935	$6,500	$4,000*

* Items marked thus designate losses.

Problem 112

(Ohio, November, 1936)

During 1932, The Shawnee Corporation purchased 1,600 shares of The Tecumseh Corporation stock. Each year thereafter, the subsidiary's profit and loss and dividends were taken up on the parent company's books through the investment account.

The trial balances of the two corporations at October 31, 1936, were as follows:

Debits	Shawnee Corporation	Tecumseh Corporation
Cash	$ 20,000	$ 30,000
Notes receivable	5,000	
Accounts receivable—customers	82,000	85,000
Accounts receivable—Tecumseh Corporation	32,000	
Inventories, November 1, 1935	31,000	81,000
Plant and equipment	660,000	300,000
Investments:		
Tecumseh stock—1,600 shares	130,000	
Tecumseh 6% bonds	50,000	
Goodwill and patents	40,000	15,000
Purchases	110,000	60,000
Labor	170,000	40,000
Factory overhead	197,000	48,000
Selling expenses	90,000	58,000
Administrative expenses	54,000	46,000
Bond interest paid	3,000	6,000
Other interest earned and paid, net	4,500	2,000
Dividends paid	50,000	20,000
Totals	$1,728,500	$791,000

Credits		
Notes payable	$ 58,500	$ 39,000
Accounts payable—trade	182,000	77,000
Accounts payable—Shawnee Corporation		10,000
First mortgage 6% bonds	50,000	100,000
Reserve for depreciation	140,000	60,000
Common stock:		
Shawnee Corporation—5,000 shares	500,000	
Tecumseh Corporation—2,000 shares		200,000
Surplus	50,000	55,000
Net sales	740,000	250,000
Tecumseh Corporation net profit	8,000	
Totals	$1,728,500	$791,000

Provide for the following items not on books:

Depreciation—factory buildings	$ 20,000	$ 10,000
Depreciation—office equipment	6,000	3,000
Accrued county taxes on factory property	3,000	2,000
The October 31, 1936, inventories were	191,000	101,000

The profit on intercompany sales had been eliminated except on a sale by The Shawnee Corporation to its subsidiary amounting to $20,000 (cost—$11,200). These goods were shipped October 31, 1936, f.o.b. destination, and were not received by The Tecumseh Corporation until November 17, 1936.

The parent company paid a $2,000 note of the subsidiary October 31, 1936. Advice of this transaction had not reached the subsidiary until after the foregoing trial balances had been taken.

Required:

Consolidated balance-sheet, showing minority interest.

Consolidated statement of profit and loss.

Problem 113

(New York, October, 1936)

From the following data, prepare a consolidated balance-sheet of the A Company and its subsidiaries as at December 31, 1935:

Assets	A Company	B Company	C Company
Cash	$ 27,000	$ 7,500	$ 12,000
Due from customers	60,000	40,000	50,000
Inventories	95,000	80,500	
Investments:			
Stock of B Company	180,000		
Stock of C Company	100,000		
Property, plant and equipment, less depreciation	350,000	270,000	150,000
Treasury stock—at cost		80,000	
Due from affiliated companies	180,000	75,000	
Deferred charges	10,000	5,000	5,000
Totals	$1,002,000	$558,000	$217,000
Liabilities			
Notes payable	$ 60,000	$ 50,000	$ 10,000
Due creditors	20,000	25,000	12,000
Due to affiliated companies		172,600	75,000
Mortgages payable	100,000	75,000	50,000
Capital stock (all $100 par value)	500,000	200,000	100,000
Surplus	322,000	35,400	30,000*
Totals	$1,002,000	$558,000	$217,000

* Loss.

The A Company acquired its holdings of 1,500 shares in the B Company on January 1, 1934, at which date the B Company had a surplus of $60,000. The B Company then purchased the remaining 500 shares for its treasury.

The A Company is engaged in refining oil in Texas. The B Company is the wholesale distributor in New York. The B Company purchases all its product from the A Company at the market quotations f.o.b. Houston. The transportation charges from Houston to New York average 12 cents per barrel.

The C Company was [illegible] January 1, 1935, to take over the retail distribution of fuel oil and purchases all its product from the B Company as required. At the date of organization, it purchased from the B Company for $175,000 delivery equipment which had a book value on the vendor's books of $125,000.

The inventory of the A Company is priced at a cost of 95 cents per barrel, which was less than the market in Texas. The inventory in New York is priced at the New York Harbor market of $1.15, which was less than the cost to the B Company.

The difference in the intercompany accounts of the A Company and the B Company is the amount of disputed prices charged for oil delivered by the A Company to the B Company.

Problem 114

(District of Columbia, May, 1932)

From the following information prepare a consolidated work sheet of the Ames Manufacturing Company and its subsidiaries at December 31, 1931:

Assets	Ames Manufacturing Company	Stuart-Jones Company	Baher Motor Company
Cash	$ 326,126.17	$ 101,692.20	$ 13,322.16
Inventories	533,826.33	412,312.71	102,224.24
Other current assets	553,863.50	373,115.41	108,575.91
Investments: Stuart-Jones Company	960,000.00		289,062.50
Investment: Baher Motor Company	400,000.00		
Securities, at cost	100,000.00		69,000.00
Plant and equipment less accrued depreciation	3,196,498 20	1,868,987.06	465,470.70
Total assets	$6,070,314.20	$2,756,107.38	$1,047,655.51

Liabilities and net worth	Ames Manufacturing Company	Stuart-Jones Company	Baher Motor Company
Accounts payable and accrued expenses	$ 540,281.10	$ 267,161.36	$ 122,322 38
Collateral trust 6% bonds due July 1, 1940	500,000.00		
First-mortgage 6% bonds	1,000,000.00	500,000.00	200,000.00
6% preferred stock, par $100	1,000,000.00		200,000.00
Common stock, no par		1,204,816.00	
Common stock, par $100	1,836,400.00		400,000.00
Surplus, January 1, 1931	603,000.00	557,313.50	146,718 23
Profits—year ending December 31, 1931	590,633.10	226,816.52	*21,385.10**
Total liabilities and net worth	$6,070,314.20	$2,756,107.38	$1,047,655 51

* Red.

The Ames Manufacturing Company investments were made up of stocks in the following companies:

STUART-JONES COMPANY

Date purchased	Class of stock	Shares	Cost
June 30, 1930	No-par common	57,750	$800,000.00
May 8, 1931	No-par common	10,500	160,000.00
Totals		68,250	$960,000.00

BAHER MOTOR COMPANY

Date purchased	Class of stock	Shares	Cost
January 1, 1923	Preferred, par $100.00	1,000	$ 85,000.00
January 1, 1924	Common, par $100.00	3,800	315,000.00
Total			$400,000.00

The preferred stock of the Baher Motor Company is 6 per cent cumulative and nonvoting. Dividends on this preferred stock were in arrears from January 1, 1922, until December 31, 1927, when they were paid in full; all subsequent annual preferred dividends have been paid at the end of each calendar year.

The Baher Motor Company investment in the Stuart-Jones Company comprised the following:

Date purchased	Class of stock	Shares	Cost
January 1, 1926	No-par common	13,125	$125,000 00
December 31, 1929	No-par common	13,125	164,062.50*
Total			$289,062.50

* Represents a 100 per cent stock dividend which was capitalized at $12.50 a share and taken up as income. An entry was made at December 31, 1929, on the books of the Stuart-Jones Company transferring $656,250.00 from earned surplus to capital stock.

The net worth of the Stuart-Jones Company at the dates the Ames Manufacturing Company and the Baher Motor Company acquired its stock was:

Particulars	January 1, 1926	June 30, 1930	May 8, 1931
Shares outstanding	52,500	105,000	105,000
Capital stock account	$548,566.00	$1,204,816.00	$1,204,816 00
Surplus	41,396.00	690,859 90	736,929 70
Total net worth	$589,962.00	$1,895,675.90	$1,941,745.70

The net worth of the Baher Motor Company at January 1, 1923, and January 1, 1924, was:

Particulars	January 1, 1923	January 1, 1924
Preferred stock	$200,000.00	$200,000.00
Common stock	400,000.00	400,000.00
Surplus	*76,918 33**	*64,360.00**
Total	$523,081.67	$535,640.00

* Red.

No subsidiary profits have been taken up on the Ames Manufacturing Company books except in the form of dividends.

The inventories of the Ames Manufacturing Company at December 31, 1931, included purchases in 1931 from the Stuart-Jones Company on which the latter company made a gross profit

of $61,326.19; similar purchases from the Baher Motor Company were also included in the inventory, the gross profit to the Baher Motor Company being $26,382.44.

On March 6, 1931, the Ames Manufacturing Company sold certain securities to the Stuart-Jones Company for $75,000, the profit realized by the Ames Manufacturing Company on this transaction being $12,000. On December 5, 1931, the same securities were purchased by the Baher Motor Company for $69,000. The purchase price at both dates was in accordance with the market values then existing.

Intercompany accounts, included in other current assets and accounts payable, at December 31, 1931, were:

Owing to	Owing by	Amount
Stuart-Jones Company	Ames Manufacturing Company	$149,382.12
Baher Motor Company	Ames Manufacturing Company	26,444 51
Stuart-Jones Company	Baher Motor Company	15,000 00

Problem 115

(Wisconsin, November, 1932)

Upon the completion of your audit of the Boiler Manufacturing Company of Milwaukee you prepared the following comparative balance-sheets of the company.

Boiler Manufacturing Company

Assets	1930	1931
Real estate, plants, etc	$12,307,184	$12,566,315
Foreign assets	577,520	577,520
Investments, stocks and securities	2,335,449	2,155,050
Cash	724,268	2,188,043
Accounts receivable	7,183,613	11,146,986
Notes receivable	122,728	159,611
Inventories	11,855,501	11,638,912
Liberty bonds		2,025,040
Totals	$35,106,263	$42,457,477
Liabilities		
Capital stock	$15,000,000	$15,000,000
Accounts and notes payable	5,874,261	7,153,375
Uncompleted contracts	3,202,600	4,227,325
Advanced payments	2,779,895	5,770,005
Depreciation reserves	1,028,942	1,590,498
Surplus	7,220,565	8,716,274
Totals	$35,106,263	$42,457,477

Dividends are at the rate of 8 per cent per annum. The last quarterly dividend has been declared but not yet set up.

The Boiler Manufacturing Company controls a subsidiary corporation, the Superior Shipbuilding Company. The Boiler Manufacturing Company manufactures water-tube steam boilers for stationary and marine purposes, mechanical stokers, steam superheaters, accessories, etc. Some years ago it found it necessary to take over the management of the Shipbuilding Company to protect its interests. This was accomplished by acquiring 12,750 shares of 85 per cent of the common stock for which $1,655,000 was paid. The surplus of the Superior Shipbuilding Company on date of acquisition was $208,600.

The following comparative balance-sheet of the Superior Shipbuilding Company, prepared by one of your senior accountants, has just been received.

SUPERIOR SHIPBUILDING COMPANY

	1930	1931
Plant, property, etc.	$2,353,077	$2,403,618
Goodwill	713,359	713,359
Merchandise inventory	419,779	429,010
Cash	230,600	190,054
Accounts receivable	238,000	211,900
Liberty bonds	27,480	135,132
Construction in progress	1,894,339	1,952,698
Other assets	115,837	88,796
Deferred charges	21,319	30,335
Totals	$6,013,790	$6,154,902
Common stock	$1,500,000	$1,500,000
Preferred stock	1,000,000	791,700
Bonded debt—6%	570,000	510,000
Notes and accounts payable	281,812	254,288
Advances on construction contracts	1,862,530	1,921,025
Accrued interest, payroll, etc.	121,991	100,831
Accrued taxes	189,231	114,535
Retirement reserve—preferred stock	50,000	50,000
Depreciation reserves	61,020	118,468
Surplus	377,206	794,055*
Totals	$6,013,790	$6,154,902

* A dividend of 6 per cent, or $90,000, on common stock has been declared but not yet set up in the 1931 balance-sheet.

A dividend of 7 per cent on preferred stock was declared and paid before December 31, 1931, to facilitate the retirement of stock. The amount of this dividend was $67,115 as a result of the purchase of preferred stock at various times during the year.

The following condensed operating statement is also submitted:

SUPERIOR SHIPBUILDING COMPANY
Condensed operating statement

Gross income from operations		$4,232,076
Operating costs		3,410,526
Gross profit from operations		$ 821,550
General and administrative expense		159,920
Net profit from operations		$ 661,630
Other income:		
Subsidies	$ 30,716	
Purchase discounts	5,001	
Interest income	13,070	
Miscellaneous	5,301	54,088
Total		$ 715,718
Other deductions:		
Interest on bonds	$ 32,400	
Miscellaneous	114,137	146,537
Balance		$ 569,181
Income taxes		85,217
Net profit to surplus		$ 483,964

1. Preferred stock has no voting power and has no further interest in surplus after receiving the specified dividend of 7 per cent.
2. The stock of the Superior Shipbuilding Company which is owned by the Boiler Manufacturing Company is carried at cost in the account called investments, stocks and securities. This account also contains $450,000 of bonds of the subsidiary company which were purchased at par. The bonds are 6 per cent obligations with interest payable semi-annually January 1 and July 1. The liability for interest has been recognized as an accrual by the subsidiary, but the parent company has not yet recorded the interest receivable.
3. In December, 1929, machinery was shipped to the Superior Shipbuilding Company at an invoiced price of $265,400. The estimated gross profit on this sale was 35 per cent of selling price. The entire amount was installed as permanent equipment by the subsidiary and depreciated at the rate of 5 per cent for 1930 and 1931 on its records.
4. The Boiler Manufacturing Company is continually selling equipment to the Superior Shipbuilding Company which it uses in equipping the ships that it builds. The 1930 inventory of construction in progress included at billed price $418,124 and the 1931 inventory at billed price $503,600 of

such merchandise. The estimated gross profit on this line for both 1930 and 1931 is 30 per cent.

5. Sales of merchandise from the Boiler Manufacturing Company to the Superior Shipbuilding Company amounted to $1,304,627 and cost $913,200 to produce.
6. Included in the accounts receivable of the Boiler Manufacturing Company in 1931 is $53,108 which also appears as an accounts payable on the subsidiary's books.
7. The Boiler Manufacturing Company held a note for $25,000 given by the Superior Shipbuilding Company. In December, 1931, it discounted this note at the bank.
   The record was made as follows:

Cash	$25,000	
Notes receivable		$25,000

You learn that this entire procedure was due to the desire to accommodate an officer of the subsidiary with a personal loan and yet make it a matter of approved record on the part of the parent company. The officers' account appears among the accounts receivable of the subsidiary.

From the preceding data, prepare:

1. Work sheet to obtain consolidated balance-sheet data for 1931.
2. Supporting schedules to show detailed method of obtaining eliminations used in work sheet.
3. Consolidated balance-sheet for 1931 in correct form.

Problem 116

(District of Columbia, May, 1930)

MAXWELL LUMBER COMPANY
Balance-sheet, December 31, 1929

Assets

Cash	$ 72,581.16
Receivables	620,486.74
Inventories	1,596,223.01
Investments	275,200.00
Bond discount	12,500.00
Land	145,068.00
Buildings	317,625.88
Trucks	58,392.15
Equipment	26,663.42
Furniture and fixtures	5,118.63
Goodwill	1.00
Total assets	$3,129,859.99

Liabilities and net worth

Accruals	$ 36,236.41
Notes payable	75,000.00
Accounts payable	310,689.77
Depreciation reserve for buildings	95,322.60
Depreciation reserve for trucks	32,481.32
Depreciation reserve for equipment	6,040.78
Depreciation reserve for furniture and fixtures	1,114.55
6½ % first-mortgage bonds	225,000.00
Reserve for bad debts	17,256.01
7 % preferred stock, par $100 per share	500,000.00
Common stock, no-par value, 14,260 shares outstanding	1,000,000.00
Surplus	689,045.92
Net profits, 1929	141,672.63
Total liabilities and net worth	$3,129,859.99

1. Receivables include $10,000 of cash advances to Glazed Tile Roofing Company, $17,500 of advances to officers of the company and $20,415.98 for materials sold to Herrick Construction Company. Accounts totaling $216,476 are supported by notes, of which $5,260 are past due and are of little or no value in the judgment of the management.
2. Inventories include $6,586.24 of roofing tile purchased from the Glazed Tile Roofing Company which had been invoiced at prices that realized 12½ per cent profit on sales.
3. Investments included $10,000 in certificates of deposit, $11,500 in county and municipal bonds, 1,150 shares of Glazed Tile Roofing Company stock and 1,387 shares of Herrick Construction Company stock. The bonds were received in payment of accounts and are valued at par. The stock is also held at par, although the Herrick stock was purchased from an estate on January 1, 1929, at the average price of $115 per share, the premium having been charged off as a 1929 expense. The Glazed Tile Roofing Company stock had been purchased at the date of organization at par.
4. Buildings include $88,984.42 of billings from the Herrick Construction Company on an uncompleted contract for the erection of mills and yards in outside towns.
5. In accounts payable is the sum of $3,049.16 due the Glazed Tile Roofing Company on open account and $5,200.60 due the Herrick Construction Company on the building con-

tract. Additional billing of $7,442.31 dated December 31, 1929, and received January 2, 1930, was not reflected on the books.

6. The first-mortgage serial bonds are dated November 15, 1928. Interest is payable semi-annually and has been met and accrued to date. Bond discount has not been amortized. The total issue was $250,000. The indenture specifies that the bonds be retired at the rate of $25,000 on November 15 of each year at a premium of 4½ per cent the first year and ½ per cent less for each succeeding year thereafter.
7. The minutes of the board of directors who met December 30, 1929, record a resolution to pay the regular semi-annual dividend on preferred stock January 1, 1930. Reflection of this resolution on the company's books is contained in an entry of January 1, 1930, charging surplus and crediting cash.

GLAZED TILE ROOFING COMPANY
Balance-sheet, December 31, 1929

Assets	
Cash	$ 1,720.36
Notes receivable	5,162.81
Trade accounts	21,445.70
Raw materials	2,386.22
Work in process	1,972.15
Finished stock	12,014.78
Land	10,235.00
Plant	38,727.84
Machinery	51,663.95
Equipment	1,840.60
Total assets	$147,169.41
Liabilities and net worth	
Advances from Maxwell Lumber Company	$ 10,000.00
Accounts payable	16,572.02
Accruals	1,685.91
Depreciation reserve on plant	1,393.28
Depreciation reserve for machinery	4,320.70
Depreciation reserve for equipment	1,184.06
Capital stock, $100 par value (1,250 shares)	125,000.00
Surplus	16,601.38*
Net profits, 1929	3,614 82
Total liabilities and net worth	$147,169.41

* Red.

1. Trade accounts included $3,049.16 due from Maxwell Lumber Company, $10,480.09 due from Herrick Construction Company and $1,455.25 due from a firm then in bankruptcy court and on which the management reports a possible recovery of 20 per cent. The remaining receivables are considered good.
2. Plant consists entirely of buildings erected by the Herrick Construction Company in 1927, the contract for which netted the latter a profit of $4,966.72.
3. Accounts payable include bank loans of $10,000 guaranteed by the Maxwell Lumber Company.

HERRICK CONSTRUCTION COMPANY
Balance-sheet, December 31, 1929

Assets	
Cash	$ 11,268.41
Receivables	208,411.26
Inventories—materials	16,400.38
Investments	110,000.00
Machinery and tools	31,126.72
Trucks and automobiles	22,009.56
Furniture and fixtures	2,833.29
Goodwill (acquired in exchange for stock)	32,415 20
Work in process	496,211.17
Profits absorbed on uncompleted contracts	97,064 28
Total assets	$1,027,740.27
Liabilities and net worth	
Notes payable	$ 60,475.25
Accounts payable	52,180.61
Depreciation reserve for machinery	12,419.22
Depreciation reserve for furniture and fixtures	570.46
Depreciation reserve for trucks and automobiles	15,619.30
Billings on uncompleted contracts	547,218.96
Capital stock—no-par value (1,460 shares issued)	146,000.00
Surplus	118,837.57
Profit for 1929	64,418.90
Reserve for bad debts	10,000.00
Total liabilities and net worth	$1,027,740.27

1. Cash includes bank deposits and a petty-cash fund of $500, analysis of which shows on December 31, 1929, I.O.U.'s signed by officers and employees totaling $395, all of several months' stand-

ing, and petty-cash vouchers covering miscellaneous expenses of $84.16.

2. Receivables includes $12,642.91 due from Maxwell Lumber Company on contract.

3. Investments include $10,000 of stock in Glazed Tile Roofing Company and $100,000 of the Maxwell Lumber Company first-mortgage bonds, on which interest income has not been accrued. Glazed Tile Roofing Company stock was purchased for cash at organization of company in 1927. Bonds were purchased at $96 and appreciated to par value by a credit to surplus December, 1928. Original purchase was 110 bonds of $1,000 face value, 10 bonds being retired by the Maxwell Lumber Company on November 15, 1929.

4. Work in process includes the following items applicable to the Maxwell Lumber Company contract:

Material	$41,388.47
Labor	31,467.28
Overhead	9,106.97
Total cost to date	$81,962.72

Material used on this job includes $17,823.12 of lumber purchased during 1929 from the Maxwell Lumber Company, at cost plus 12½ per cent. It also included $3,659.40 of materials purchased during 1929 from the Glazed Tile Roofing Company, billed to net 10 per cent profit on sales.

5. Material inventory and work in process include, respectively, $3,426.40 and $93,100.24 of items purchased from Maxwell Lumber Company during 1929 on which the lumber company netted an average profit on sales of 12½ per cent. Products bought from the tile company in 1929 and included in the two inventories total, respectively, $575.22 and $17,697.89, on which the Glazed Tile Roofing Company realized a profit of 10 per cent on sales.

6. Profits absorbed on uncompleted contracts represent the prorata share of the estimated profit to be realized, based on the amount of cost already incurred or the total work in process.

7. Notes payable include bank loans of $35,000 secured by the Maxwell Lumber Company bonds.

8. Billings are computed so that they bear the same ratio to the total contract price as the costs to date bear to the total

estimated cost. Billings are made periodically as the work progresses and as additional costs are added to work in process. The book balance of billings on uncompleted contracts includes billings to the Maxwell Lumber Company of $96,426.73 which covers work in process up to December 31, 1929. Billings to other customers totaling $46,056.49 and entered on the books January 13, 1930, completed the billings on all work in process up to December 31, 1929.

9. Accounts payable include $20,415.98 due Maxwell Lumber Company and $10,480.09 due Glazed Tile Roofing Company.

From the preceding information prepare a consolidated balance-sheet, and affix thereto your certificate.

Problem 117

(Ohio, October, 1937)

A Company and B Company have been requested to submit to their bankers a consolidated balance-sheet as of the close business December 31, 1936, and summary of profit and loss surplus transactions for the year. Your assignment is to prepare these statements, properly certified, without detailed audit report but in the form generally accepted as good accounting practice.

Assets	A Company	B Company
Cash (deposits in various banks)	$ 350,000	$ 25,000*
Notes receivable	50,000	45,000
Accounts receivable	290,000	130,000
Inventories (lower of cost or market)	500,000	200,000
Investments:		
Mortgage receivable—B Company	160,000	
100,000 shares B Company (at cost) purchased upon organization	1,000,000	
Treasury stock 20,000 shares common at cost	100,000	
Sinking fund (cash on deposit)	40,000	
Land	300,000	100,000
Buildings	750,000	400,000
Machinery and equipment	1,000,000	500,000
Prepaid expenses	10,000	5,000
Deferred experimental—1935 product	25,000	
Totals	$4,575,000	$1,355,000

Liabilities		
Notes payable (90 days) due to banks (includes $25,000 owed by B Company to broker due on demand)	$ 100,000	$ 125,000
Accounts payable and accrued expense	275,000	183,000
Mortgage payable	400,000	150,000
Reserve for depreciation (computed on cost):		
Buildings	50,000	17,000
Machinery and equipment	145,000	100,000
Reserve for doubtful notes and accounts	15,000	5,000
Sinking-fund reserve	40,000	
Reserve for contingencies	75,000	
Preferred—$50 par—10,000 shares	500,000	
Common:		
150,000 shares—no par	1,500,000	
100,000 shares—no par		500,000
Unearned and paid-in surplus	900,000	
Paid-in surplus		300,000
Profit and loss surplus	575,000	(25,000)*
Totals	$4,575,000	$1,355,000
Profit and loss surplus, January 1, 1936	$ 460,000	$ (75,000)*
Profit before federal taxes	215,000	50,000
Totals	$ 675,000	$ (25,000)*
Dividends paid in 1936	100,000	
Balance, December 31, 1936	$ 575,000	$ (25,000)*

* Indicates overdraft and deficits.

The A Company

On November 30, 1936, purchase commitments were made for 5,000 tons of steel at $35 per ton to be delivered in February, 1937. (Market value December 31, 1936—$30 per ton.)

Inventory includes $60,000 representing cost of material purchased from B Company.

Judgment of $25,000 for damages, resulting from defective material, rendered against the company in 1936, was paid and charged to reserve for contingencies. On January 2, 1937, a similar judgment of $10,000 was rendered which the company expects to appeal.

During January, 1936, a loan of $100,000 was made to the B Company, and interest received thereon during the year amounted to $5,000. This loan was paid in December, 1936, and on January 2, 1937, reloaned to B Company.

Notes receivable at December 31, 1936, were pledged as security on loan made by broker to B Company.

Land, buildings and machinery of A Company are stated at appraised reproductive values as of January 1, 1936. There have been no additions during the year. The cost of these properties together with the sound values and remaining life at time of appraisal follow:

	Cost	Sound value	Remaining life
Land	$150,000	$300,000	
Buildings	400,000	500,000	50 years
Machinery and equipment	600,000	800,000	12½ years

Mortgage is due in annual installments of $100,000 on July 1.

Dividends received on investments in B Company have been credited to unearned and paid-in surplus.

Abandoned warehouse of a book value of $200,000 (not included in appraisal) has been charged off to unearned and paid-in surplus in a prior year, but no audited report had been submitted to the company's bankers for that year.

Adjusted declared value of capital stock for excess profits tax in 1936 is $1,600,000.

The B Company

This company was organized January 1, 1933, and dividends of $50,000 per annum have been consistently paid and charged to paid-in surplus.

The company was able to market its product throughout the year at 20 per cent in excess of factory cost.

Notes receivable (including $25,000 due January 15, 1938) were pledged at December 31, 1936, as security on loan from brokers.

On December 31, 1936, the company made a payment of $10,000 on its mortgage which was mailed but not credited until January 2, 1937.

At the time of organization the company purchased its land from Company A. The cost to Company A was $75,000.

Adjusted declared value of capital stock for excess profits tax in 1936 is $600,000.

NOTE.—No computation need be made for capital stock tax liability for the year ended June 30, 1937.

Problem 118

(Ohio, November, 1935)

Prepare from the information given below the following statements in report form:

Consolidated balance-sheet as of December 31, 1934.
Analysis of consolidated surplus account for the period January 1, 1933, to December 31, 1934.
Statement of minority interest at December 31, 1934.

Balance-sheets, December 31, 1934

Assets	Parent company	Subsidiary A	Subsidiary B
Cash	$ 75,000	$ 30,000	$ 60,000
Accounts receivable	300,000	220,000	780,000
Inventories[1]	600,000	405,000	1,300,000
Sinking-fund assets			25,000
Deferred charges	10,000	5,000	20,000
Investments—at cost:			
Subsidiary A[2]	920,000		
Subsidiary B[3]	1,660,000	220,000	
Advances to Subsidiary B	100,000		
Bonds of Subsidiary B—at par		100,000	
Land, buildings and equipment	500,000	600,000	1,200,000
Totals	$4,165,000	$1,580,000	$3,385,000
Liabilities			
Accounts payable	$ 215,000	$ 170,000	$ 434,000
Dividends payable			10,000
Bonds payable—6%			200,000
Accrued interest on bonds[4]			6,000
Reserve for depreciation	150,000	60,000	180,000
Reserve for bad debts	50,000	20,000	80,000
Sinking-fund reserve			25,000
Capital stock[5]:			
No par—50,000 shares	3,000,000		
$100 par—10,000 shares		1,000,000	
$100 par—20,000 shares			2,000,000
Paid-in surplus[6]			200,000
Earned surplus	750,000	330,000	250,000
Totals	$4,165,000	$1,580,000	$3,385,000

Earned surplus account

	Parent company	Subsidiary A	Subsidiary B
Balance—December 31, 1932	$ 450,000	$ 200,000	$ 50,000
Net operating income:			
Year ended December 31, 1933[7]	200,000	80,000	110,000
Year ended December 31, 1934[7]	150,000	60,000	120,000
Total	$ 800,000	$ 340,000	$ 280,000
Appropriation to sinking fund:			
December 31, 1933			10,000
December 31, 1934			10,000
Dividends declared—December 30, 1934:			
Paid December 31, 1934	50,000	10,000	
Payable January 2, 1935			10,000
Balance, December 31, 1934	$ 750,000	$ 330,000	$ 250,000

[1] Parent Company inventory at December 31, 1934, contained merchandise purchased from Subsidiary A for $50,000 which cost to produce $40,000.

[2] Stock purchased:

January 1, 1933, 6,000 shares @ $110 per share
December 31, 1933, 2,000 shares @ $130 per share

[3] Stock purchased by Parent Company:

January 1, 1933, 10,000 shares @ $100 per share
January 1, 1934, 6,000 shares @ $110 per share

Stock purchased by Subsidiary A:

January 1, 1934, 2,000 shares @ $110 per share

[4] Represents six months' accrued interest on bonds to December 31, 1934.

[5] All authorized stocks were issued and outstanding as of December 31, 1932.

[6] Two thousand shares of stock donated pro rata by all holders on December 31, 1933, and immediately sold at par value.

[7] Includes all dividends actually received from subsidiary companies.

Problem 119

(American Institute of Accountants, November, 1935)

The following is a summary of an analysis of the "investment in subsidiary companies" account in the ledger of the "P" Company as at June 30, 1935:

Company	Class of stock	Number of shares issued and outstanding	Number of shares owned	Amount at which shares are carried	Last dividend paid or declared for the period ended
"A" Company	7% First preferred	5,000	4,000	$ 200,000	June 30, 1932
	7% Second preferred	5,000	4,900	245,000	June 30, 1932
	Common	10,000	9,900	100,000	Sept. 30, 1929
"B" Company	7% Cumulative pref.	10,000	8,000	800,000	June 30, 1933
	Common	10,000	10,000	1,000,000	June 30, 1933
"C" Company	6% Cumulative pref.	5,000	4,500	450,000	Sept. 30, 1934
	Common	5,000	5,000	500,000	Sept. 30, 1934
Total				$3,295,000	

The certificate of incorporation of the "A" Company stipulates that in the event of dissolution the 7% first preferred stock shall be entitled to $75 per share before any distribution is made to holders of any other class of stock, and no more. It further provides that after $75 per share has been distributed to the holders of the 7% first preferred stock the holders of the 7% second preferred stock shall be entitled to receive $62.50 per share before any distribution is made to the holders of the common stock, and no more. The balance is to be distributed to the holders of the common stock.

The certificate of incorporation of the "B" Company stipulates that, in the event of liquidation or winding up, the 7% cumulative preferred stock shall be entitled to $105, plus all dividends, before any distribution is made to the holders of the common stock, and no more. The balance is to be distributed to the holders of the common stock.

The certificate of incorporation of the "C" Company stipulates that after providing for all unpaid dividends on the 6% cumulative preferred stock the holders of the preferred and common stocks shall, in the event of dissolution, liquidation or winding up, be entitled, share and share alike, to all remaining assets.

A condensed summary of the assets and liabilities of the several companies as at June 30, 1935, is shown below:

	"A"	"B"	"C"	"D"	"P"
Current assets	$450,000	$1,000,000	$1,200,000	$150,000	$ 100,000
Treasury stock:					
600 shares of "D" Company common				6,250	
Investments:					
1,000 shares of "B" Company 7% cumulative preferred	50,500				
9,000 shares of "D" Company common			112,500		
Per analysis					3,295,000
Fixed assets, less depreciation	200,000	1,200,000	200,000	17,000	
Other assets	9,500	165,000	27,500	250	25,000
Total assets	$710,000	$2,365,000	$1,540,000	$173,500	$3,420,000
Current liabilities	$ 85,000	$ 165,000	$ 240,000	$ 26,250	$ 70,000
Mortgages payable		300,000			
Capital stock					
7% First preferred	250,000				
7% Second preferred	250,000				
7% Cumulative preferred		1,000,000			
6% Cumulative preferred			500,000		
Common	100,000	1,000,000	500,000	100,000	3,000,000
Surplus or *deficit*	25,000	*100,000*	300,000	47,250	350,000
Total liabilities	$710,000	$2,365,000	$1,540,000	$173,500	$3,420,000

Prepare a schedule of the minority interest, assuming liquidation at book value.

Problem 120

(American Institute of Accountants, November, 1932)

From the following data, you are required to prepare a consolidated balance-sheet of company A and subsidiaries, as at December 31, 1931, including an analysis of consolidated surplus for 1930 and 1931.

	Date	Cost
1. Acquisitions		
A—20 per cent of stock of B	Dec. 31, 1929	$180,000
A—45 " " " " " B	Mar. 31, 1930	400,000
A—25 " " " " " B	Sept. 30, 1930	270,000
90 per cent		$850,000
2. A—20 per cent of stock of C	Dec. 31, 1930	
B—60 " " " " " C	Dec. 31, 1931	
A—95 " " " pref. stock of D	Dec. 31, 1930	
A—80 " " " com. " " D	Dec. 31, 1930	
A—20 " " " stock of E	Dec. 31, 1930	

3. The profits of B for the year 1930 were earned as follows:

First quarter	$ 30,000
Second "	50,000
Third "	70,000
Fourth "	75,000
	$225,000

4. B drew a cheque for $5,000 in favor of A on December 31, 1931, which was not received and therefore not recorded by A until January 2, 1932.
5. Included in the inventories of B, at December 31, 1931, were goods purchased from A in 1931, amounting to $100,000, on which A had taken up a profit of 20 per cent.
6. A has included dividends received from B and E in its profits.
7. The preferred stock of A is 7 per cent cumulative, and dividends have been paid thereon to December 31, 1931. The preferred stock of D is 6 per cent non-cumulative and non-participating, and dividends have been paid to December 31, 1930.

The balance-sheets of the several companies, as of December 31, 1931, were as follows:

Assets	A	B	C	D	E
Cash	$ 100,000	$ 95,000	$ 25,000	$ 10,000	$ 30,000
Receivables	540,000	425,000	145,000	20,000	70,000
Inventories	500,000	400,000	100,000	50,000	25,000
Advances:					
To A		100,000			
To C		60,000			
To D	110,000				
Investments:					
In stock of B (90%) at cost	850,000				
In stock of C (20%) at cost	40,000				
In stock of C (60%) at cost		130,000			
In preferred stock of D (95%) at cost	95,000				
In common stock of D (80%) at cost	40,000				
In stock of E (20%) at cost	15,000				
Fixed assets	1,500,000	450,000	150,000	100,000	50,000
Goodwill			20,000	20,000	
Totals	$3,790,000	$1,660,000	$440,000	$200,000	$175,000
Liabilities and capital					
Accounts payable	$ 535,000	$ 420,000	$155,000	$ 16,000	$ 60,000
Advances:					
From A				110,000	
From B	95,000		60,000		
Capital stock:					
Preferred—par value $100	1,000,000			100,000	
Common—par value $100	1,000,000	700,000	200,000	50,000	100,000
Surplus:					
Balances, Dec. 31, 1929	880,000	100,000	18,000		
Profits—1930	530,000	225,000	2,000	10,000	20,000*
Profits—1931	390,000	375,000	5,000	80,000*	50,000
Dividends paid, preferred:					
1930	70,000*			6,000*	
1931	70,000*				
Dividends paid, common:					
March 15, 1930		20,000*			
December 15, 1930	300,000*	70,000*			
December 15, 1931	200,000*	70,000*			15,000*
Totals	$3,790,000	$1,660,000	$440,000	$200,000	$175,000

* Red.

Problem 121

(American Institute of Accountants, May, 1934)

From the accounts and information given below prepare:

(a) Consolidated balance-sheet.
(b) Consolidated goodwill and capital surplus account.
(c) Consolidated earned surplus account.
(d) Any necessary comments required for correct interpretation of the accounts as presented.

BALANCE-SHEETS, DECEMBER 31, 1933

	A Company	B Company	D Company
Accounts receivable	$ 346,480	$ 132,740	$ 68,740
Cash surrender value of life-insurance policies	15,480		
Cash in bank	224,682	59,420	9,720
Deferred charges	14,620	6,232	2,740
Inventories	462,000	267,032	109,630
Investment in B Company—4,000 shares at cost	600,000		
Investment in D Company—800 shares at cost		200,000	
Land, buildings, machinery and equipment	897,306	408,784	273,086
Receivable from D Company		16,836	
Totals	$2,560,568	$1,091,044	$463,916
Accounts payable	$ 326,740	$ 127,630	$ 96,940
Reserve for depreciation	370,620	138,760	96,320
Reserve for bad debts	38,000	17,000	10,000
Capital stock—common:			
10,000 shares of $100 each	1,000,000		
5,000 shares of $100 each		500,000	
1,000 shares of $100 each			100,000
Earned surplus	825,208	307,654	143,820
Payable to B Company			16,836
Totals	$2,560,568	$1,091,044	$463,916

EARNED SURPLUS ACCOUNTS

Surplus as at December 31, 1931	$ 720,808	$ 285,672	$126,948
Net operating income:			
Six months ended June 30, 1932	8,260	2,762	974
Six months ended December 31, 1932	12,390	4,710	2,978
Dividends on B Company stock received September 30, 1933	20,000		
Excess of proceeds of sale of E Company stock over cost	50,000		
Net operating income:			
Six months ended June 30, 1933	32,640	11,690	3,276
Six months ended December 31, 1933	81,110	27,820	9,644
Totals	$ 925,208	$ 332,654	$143,820
Dividends paid	100,000	25,000	
Earned surplus per books December 31, 1933	$ 825,208	$ 307,654	$143,820

The A Company acquired 3,750 shares of common stock of the B Company on January 1, 1933, and a further acquisition

was made of 250 shares on June 30, 1933, the cost price in both cases being $150 a share. The B Company acquired 800 shares of the D Company—an 80% interest—on June 30, 1932, for $200,000.

The A Company owned all of the capital stock of the E Company from June 30, 1927, to September 30, 1933. At the latter date the stock was sold for $100,000, or $50,000 more than the purchase price. The net worth of the E Company amounted to $60,460 on June 30, 1927. By December 31, 1932, it had increased through earnings to $87,630 and by September 30, 1933, it showed further earnings, the capital and surplus then amounting to $93,920.

The inventory of the A Company at December 31, 1932, contained merchandise acquired from the E Company, valued at $18,700, the sum billed by the latter company. The goods had been produced by the E Company at a cost of $17,000.

Problem 122

(American Institute of Accountants, May, 1936)

Phoenix Smelting Company (Co. A) has agreed to purchase the minority interest in Phoenix Mining Co. (Co. B). Their balance-sheets show:

	(Co. A) Phoenix Smelting Co.		(Co. B) Phoenix Mining Co.
Assets:			
Tangible assets	$3,764,513		$2,264,718
Goodwill	500,000		
91,000 shares of Co. B	1,270,000	5,373 shares Co. A	622,443
Total	$5,534,513	Total	$2,887,161
Liabilities:			
Creditors	$ 367,423		$ 133,675
Capital stock 40,000 shares	4,000,000	100,000 shares	2,500,000
Surplus	1,167,090		253,486
Total	$5,534,513	Total	$2,887,161

The stock is to be acquired at asset value, but in the computation the goodwill of either company is not to be considered.

How much should be paid to the minority stockholders per share of Company B? Do not carry your computation further than whole cents per share.

Problem 123

(American Institute of Accountants, November, 1936)

Company A owns 40% of the capital stock of company B
" A " 30% " " " " " " C
" B " 10% " " " " " " A
" B " 50% " " " " " " C
" C " 10% " " " " " " A
" C " 40% " " " " " " B

Each company has 10% of its capital stock in its treasury and all stocks are carried on the books at cost.

The assets of the three companies are:

	A	B	C
Investment in A.	$ 10,000	$12,000	$15,000
" " B.	20,000	4,000	10,000
" " C.	30,000	15,000	2,000
Other assets (net)	100,000	50,000	30,000
Totals	$160,000	$81,000	$57,000

(a) Determine the respective amounts of net assets belonging to the outside shareholders of companies A, B and C. Do not consider fractions of dollars in any of the calculations.

(b) Are all the facts given in this problem essential to its solution? If not, show the irrelevant data.

Problem 124

(American Institute of Accountants, May, 1933)

Company A is a holding company with subsidiary companies B, C, and D. From the information submitted, prepare a statement showing the earnings per share of all the companies applicable to that part of the common capital stock of Company A which is held by the public.

The income and surplus accounts of the several companies, for the year ended December 31, 1932, were as follows:

	Companies			
	A	B	C	D
Net sales		$2,000,000	$300,000	$120,000
Cost of sales		630,000	160,000	42,000
Gross profit		$1,370,000	$140,000	$ 78,000
Selling and delivery expenses		512,000	42,000	27,000
Selling profit		$ 858,000	$ 98,000	$ 51,000
Administrative and general expenses	$ 4,400	320,000	40,000	22,000
Profit from operations	$ 4,400*	$ 538,000	$ 58,000	$ 29,000
Income credits:				
Dividends from affiliated companies	$527,600	$ 36,350		
Income from investments		60,000	$ 2,500	$ 1,000
Discount on purchases		6,200	2,600	1,800
Interest on loan to Company A		1,800		
Totals	$527,600	$ 104,350	$ 5,100	$ 2,800
Gross income	$523,200	$ 642,350	$ 63,100	$ 31,800
Income charges:				
Discount on sales		$ 24,800	$ 5,200	$ 2,200
Interest paid Company B	$ 1,800			
Bank interest and discount		3,200	400	
Federal tax on income for current year—estimated		79,800	7,900	4,100
Totals	$ 1,800	$ 107,800	$ 13,500	$ 6,300
Net income	$521,400	$ 534,550	$ 49,600	$ 25,500
Dividends paid:				
On preferred stock	$ 75,000	$ 100,000		
On common stock	375,000	400,000	$ 40,000	$ 30,000
Totals	$450,000	$ 500,000	$ 40,000	$ 30,000
Surplus	$ 71,400	$ 34,550	$ 9,600	$ 4,500*

* Loss or deficit.

The capitalization of the companies is as follows:

	Shares issued	Number of shares owned by affiliated companies A	B
Company A:			
Preferred stock	100,000		3,000
Common stock	500,000		6,000
Company B:			
Preferred stock	25,000	24,000	
Common stock	50,000	49,000	
Company C—common stock	1,000	990	
Company D— " "	1,500		1,480

All dividends on preferred stocks have been paid to the latest dividend dates at the full accumulative rates.

The unrealized inter-company profit in inventories was as follows:

	December 31 1931	1932
On sales of Company C to Company B	$40,000	$44,000
On sales of Company D to Company B	28,000	30,000
Totals	$68,000	$74,000

It is the intention of the companies to file individual federal-income-tax returns for the year.

Problem 125

(New York, November, 1931)

Following are the trial balances of Company A and its subsidiary at December 31, 1930:

Debits	Company A	Company B
Cash	$ 75,000	$ 50,000
Notes receivable	200,000	60,000
Accounts receivable	350,000	190,000
Inventory, raw material, January 1, 1930	150,000	105,000
Purchases	650,000	400,000
Labor	450,000	320,000
Manufacturing expense	190,000	190,000
Selling expenses	85,000	40,000
Administrative expenses	45,000	25,000
Inventory, goods in process, January 1, 1930	80,000	70,000
Inventory, finished goods, January 1, 1930	90,000	65,000
Plant and equipment	900,000	400,000
Investment in stock of Company B	875,000	
Totals	$4,140,000	$1,915,000
Credits		
Capital stock	$1,800,000	$ 500,000
Notes payable	110,000	80,000
Accounts payable	100,000	65,000
Bonds payable	500,000	
Premium on bonds	5,000	
Reserve for depreciation	100,000	60,000
Sales	1,400,000	1,050,000
Surplus	125,000	160,000
Totals	$4,140,000	$1,915,000

The inventories at December 31, 1930, were:

	Company A	Company B	Totals
Raw material	$280,000	$175,000	$455,000
Goods in process	95,000	80,000	175,000
Finished goods	135,000	145,000	280,000

Company A purchased the entire stock of Company B at January 1, 1930, at the price shown in the trial balance. During the year each of the two companies declared and paid a 5 per cent dividend. Company A took up its dividend from Company B by a credit to surplus. The entries for dividends were the only entries affecting the surplus accounts during the year.

During 1930, Company B sold goods to Company A at a cost of $300,000 and at a selling price of $375,000. Company A made cash advances totaling $400,000 to Company B during the year. The sales just mentioned were charged against the advances account, the $25,000 balance of which is included in Company B's accounts payable.

The inventories at December 31, 1930, include intercompany profits as follows:

	Raw material	Goods in process	Finished goods
Company A	$20,000	$5,000	$4,000

Company A's bonds were issued July 1, 1930. They bear 5 per cent interest, payable semi-annually, and mature in five years. No interest has been paid.

Allow depreciation at 5 per cent per annum on cost of fixed assets.

Prepare the following consolidated statements:

1. Cost of goods manufactured and sold.
2. Profit and loss statement.
3. Surplus statement (showing as the final balance therein the surplus balance appearing in the consolidated balance-sheet).
4. Balance-sheet.

Problem 126

(Ohio, November, 1932)

Trial balance, December 31, 1931

	Company A	Company B	Company C
Assets			
Cash on deposit	$ 12,180	$ 2,800	$ 20,184
Accounts receivable	59,120	36,520	67,182
Inventory	6,840	3,450	7,935
Buildings, machinery and equipment	121,148	78,800	157,579
Deferred	4,828	3,120	5,632
Investments	90,000		80,000
Totals	$294,116	$124,690	$338,512
Liabilities			
Accounts payable	$ 28,050	$ 28,800	$ 24,442
Accruals	1,850	3,200	2,462
Depreciation reserves	28,300	26,750	24,054
Bonds payable	50,000		50,000
Capital stock	100,000	80,000	150,000
Surplus—deficit	48,716	12,060(D)	44,954
Totals	$256,916	$126,690	$295,912
Income			
Sales	$387,000	$212,000	$500,000
Interest earned			5,600
Totals	$387,000	$212,000	$505,600
Expense			
Cost of goods sold	$212,000	$129,000	$290,000
Operating wages	34,000	20,000	45,000
Overhead	11,000	13,000	15,000
Selling	39,000	24,000	55,000
Administrative	39,000	21,000	40,000
Depreciation	11,300	7,000	15,000
Interest	3,500		3,000
Totals	$349,800	$214,000	$463,000

Company A:

Accounts receivable from Company B—$18,250.
Investments—4,000 shares of Company B at $10.
—500 shares of Company C at $100 par value
Bonds payable—7 per cent interest due semi-annually
Capital stock—1,000 shares at $100 par value

Company B:

Capital stock—8,000 shares no-par value—stated value $10 per share

Company C:

Investments—bonds of Company A—50 $1,000 bonds purchased for $102 June 30, 1931. Securities of other companies $29,000
Capital stock—1,500 shares $100 par value

The Windsor Holding Company, organized for the purpose of consolidating A, B and C companies, is authorized to issue $250,000 preferred stock and $250,000 common stock, both issues $100 par value.

The Windsor Holding Company has offered to purchase for cash the assets of Company B at 80 per cent of book value, less the cash on hand, and will issue to Company A and Company C the following stock of The Windsor Holding Company:

One share of preferred and one share of common for each share of Company A.
One share of preferred and ¾ share of common for each share of Company C.

On these terms The Windsor Holding Company acquired 80 per cent of the stock of Company A and 60 per cent of the stock of Company C. The stock acquired was obtained from individual holders, the intercompany stock of Company A not being purchased. The remaining preferred stock of The Windsor Holding Company was held by the company, and the balance of the common stock was sold for cash at par. The expenses of the organization were $5,000 paid in cash along with the purchase price of Company B. All these transactions have been consummated as of December 31, 1931.

Required of candidates:

Prepare a consolidated balance-sheet.

Prepare a consolidated profit and loss statement showing what the results would have been with Company B's plant eliminated and its business handled by Company C, without increasing its plant investment, at the same percentages of costs and operating expenses as shown by Company C's statement.

Problem 127

(American Institute of Accountants, May, 1933)

In order to obtain a controlled source of crude oil to augment its own small production, the X Refining Corporation purchased

the entire outstanding capital stock of the K O Producing Company. The latter company had developed several prolific wells in a pool area, and the owners were looking for a market for the oil. To finance the purchase of the subsidiary, the refining corporation sold $600,000 of 7 per cent preferred stock and paid cash for the capital stock of the producing company.

At December 31, 1930, you are engaged to submit a report covering the operations for the year 1930. On the basis of information furnished herewith, prepare

(1) Consolidating balance-sheet as at December 31, 1930.
(2) Consolidating profit-and-loss statement for the year 1930.
(3) Consolidated surplus account for the year 1930.

Trial-balances (per books), December 31, 1930

	X Refining Corp.	K O Producing Company
Asset accounts:		
Cash	$ 110,000	$ 24,392
Accounts receivable	125,370	42,600
Inventories	75,640	5,762
Refinery and other property (cost)	1,007,391	
Oil property—		
Lease cost		1,000
Development expense		144,328
Equipment on lease		25,541
Other assets	32,000	31,000
Investment in K O capital stock	719,500	
Totals	$2,069,901	$274,623
Liability accounts:		
Notes payable—banks	$ 150,000	
Accounts payable	113,689	$ 10,705
Accrued items	15,104	2,827
Reserves for depletion and depreciation	202,321	
Preferred stock—7 per cent	600,000	
Common stock—		
80,000 shares of $10 each	800,000	
10,000 shares of no par value		100,000
Surplus balance	188,787	161,091
Totals	$2,069,901	$274,623

Investment account in K O stock

Shares bought:			
December 10, 1929	4,900	@ $75	$367,500
December 28, 1929	1,000	@ 65	65,000
January 15, 1930	4,100	@ 70	287,000
Totals	10,000		$719,500

For practical purposes, the date of acquisition was December 31, 1929, and may be so considered in this problem.

X Refining Corporation
Profit-and-loss account (per books)

	Year 1929	Year 1930
Operating revenue	$932,609	$865,392
Operating and general expenses	765,503	775,255
Balances	$167,106	$ 90,137
Depreciation and depletion	79,886	82,401
Net operating income	$ 87,220	$ 7,736
Dividends received on K O stock	24,500	250,000
Net profit	$111,720	$257,736
Dividends paid on preferred stock		$ 42,000
Dividends paid on common stock	$ 80,000	120,000
Totals	$ 80,000	$162,000
Net revenue—to surplus	$ 31,720	$ 95,736
Opening surplus	61,331	93,051
Closing surplus	$ 93,051	$188,787

K O Producing Company
Profit-and-loss account (per books)
(Operations commenced January, 1928)

	Year 1928	Year 1929	Year 1930
Barrels of oil produced	101,330	398,742	528,067
Oil sales	$152,309	$477,822	$573,112
Operating and general expenses	136,103	271,597	284,452
Balances	$ 16,206	$206,225	$288,660
Provision for depletion			
Net income	$ 16,206	$206,225	$288,660
Dividends paid—June 15th		$ 50,000	$100,000
Dividends paid—December 15th		50,000	150,000
Totals		$100,000	$250,000
Net revenue—to surplus	$ 16,206	$106,225	$ 38,660
Opening surplus		16,206	122,431
Closing surplus	$ 16,206	$122,431	$161,091

General Information and Remarks

The oil reserves (recoverable oil underground) of the K O Producing Company were estimated, by reliable geologists, to be 1,407,600 bbls. at December 31, 1930.

No depletion has ever been provided in the accounts of the K O Producing Company.

For the sake of simplification, assume that no capital additions have been made in the period under audit.

Inter-company sales, during 1930, amounted to $373,408. Inter-company profit remaining in inventories is nominal and may be ignored.

Disregard federal-income-tax features.

Problem 128

(Wisconsin, November, 1935)

You have been requested to furnish a balance-sheet and operating statement for XYZ Company and a consolidated balance-sheet and operating statement for XYZ Company and subsidiary companies together with the necessary adjusting and eliminating entries.

You have completed your audit of these companies for the year ended December 31, 1934, and have prepared the following statements of the individual companies:

Balance-sheets, December 31, 1934

Assets	XYZ Company	A Company	B Company	C Company	D Company
Cash	$ 100,000	$ 10,000	$ 10,000	$ 5,000	$ 6,000
Receivables	200,000	50,000	100,000	140,000	60,000
Inventories	100,000	40,000	40,000	60,000	70,000
Prepaid expenses	10,000	5,000	5,000	4,000	3,000
Investments in and advances to subsidiary companies:					
Stocks	500,000				
6% bonds, at par value	250,000				
6% notes	125,000				
Accounts	110,000				
Real estate	50,000	25,000	30,000	10,000	10,000
Building machinery and equipment	500,000	300,000	200,000	100,000	100,000
Reserve for depreciation	100,000*	65,000*	40,000*	22,000*	25,000*
Total assets	$1,845,000	$365,000	$345,000	$297,000	$224,000
Liabilities					
Notes payable	$ 100,000	$ 25,000	$ 50,000	$ 30,000	$ 20,000
Accounts payable	100,000	30,000	25,000	40,000	15,000
Bonds outstanding	300,000	100,000	150,000	100,000	125,000
Capital stock outstanding	1,000,000	100,000	200,000	100,000	100,000
Capital surplus	75,000				
Earned surplus	270,000	110,000	80,000*	27,000	36,000*
Total liabilities	$1,845,000	$365,000	$345,000	$297,000	$224,000

* Deductions, or red.

Statements of profits and loss, year ended December 31, 1934

Particulars	XYZ Company	A Company	B Company	C Company	D Company
Net sales	$2,000,000	$1,000,000	$400,000	$400,000	$500,000
Deduct—cost of sales	1,727,500*	783,700*	328,600*	323,550*	391,900*
Selling, administrative and general expenses	200,000*	150,000*	100,000*	110,000*	60,000*
Interest received	22,500				
Discounts earned	2,000	1,000	500	750	500
Miscellaneous	77,000	200	100	600	100
Bond interest	18,000*	6,000*	9,000*	6,000*	7,500*
Other interest	6,000*	1,500*	3,000*	1,800*	1,200*
Net profit or loss* for year	$ 150,000	$ 60,000	$ 40,000*	$ 40,000*	$ 40,000
Earned surplus of December 31, 1934					
Balance, January 1, 1930		$ 10,000	$ 50,000*	$ 25,000	$ 25,000*
Net changes, January 1, 1930, to December 31, 1933	$ 320,000	90,000	10,000	52,000	51,000*
Profit for year 1934	150,000	60,000	40,000*	40,000*	40,000
Dividends paid	200,000*	50,000*	. .	10,000*	. . .
Balance, December 31, 1934	$ 270,000	$ 110,000	$ 80,000*	$ 27,000	$ 36,000*

* Deductions, or red.

XYZ Company was organized as at January 1, 1930, with an authorized capital stock of $1,000,000 which was issued for properties, investments and other assets, subject to certain liabilities and recorded on the books at the net value of $1,075,000, $75,000 having been credited to paid-in surplus.

Investments in subsidiaries were as follows:

Subsidiary	Acquired January 1, 1930 Par value	Cost	Acquired July 1, 1934 Par value	Cost	Balance, December 31, 1934 Par value	Cost
A	$100,000	$160,000			$100,000	$160,000
B	200,000	190,000			200,000	190,000
C	80,000	90,000			80,000	90,000
D	60,000	52,000	$10,000	$8,000	70,000	60,000
Total	$440,000	$492,000	$10,000	$8,000	$450,000	$500,000

Sales in 1934 by XYZ Company to subsidiaries, which included a profit of 10 per cent of the selling price (7½% in 1933), were as follows:

A Company	$ 400,000
B Company	200,000
C Company	200,000
D Company	200,000
Total	$1,000,000

Inventories of subsidiaries contained merchandise purchased from XYZ Company as follows:

Subsidiary	December 31, 1933	December 31, 1934
A Company	$ 40,000	$ 30,000
B Company	30,000	25,000
C Company	35,000	40,000
D Company	50,000	65,000
Total	$155,000	$160,000

Miscellaneous income ($77,000) of the XYZ Company consisted of dividends, $58,000, and service charges, $19,000, received from subsidiary companies as follows:

	Dividends	Service charges
A Company	$50,000	$ 8,000
B Company		3,000
C Company	8,000	3,000
D Company		5,000
Total	$58,000	$19,000

The service charges have been added to cost of sales by the subsidiaries.

It was decided that adjustment should be made as at December 31, 1934, for a reserve for loss in investments in subsidiaries, on the following basis:

1. Book values of investments in stocks of subsidiaries in excess of the underlying assets at the date of acquisition should be charged to paid-in surplus to the extent of the balance in that account, and the remainder to earned surplus.
2. Losses from the date of acquisition to December 31, 1933, in excess of the current year's earnings should be charged to earned surplus.
3. Losses for the current year in excess of profits from acquisition to December 31, 1933, should be charged to profit and loss.
4. Profits should not be taken up except to offset losses.

Problem 129

(District of Columbia, May, 1936)

You are engaged to audit the accounts of XYZ Corporation and its subsidiaries. In connection therewith, the following condensed balance-sheets and income accounts are presented for your verification:

Condensed balance-sheets, December 31, 1935

Assets	XYZ Corporation	Manufacturing Company	Distributing Company
Cash	$ 1,409,000	$ 331,000	$ 346,000
Notes and accounts receivable:			
Trade, net	2,151,000	764,000	1,680,000
Intercompany	746,000	462,000	51,000
Inventories	6,131,000	1,868,000	821,000
Investments:			
Marketable securities	262,000		
Stocks of affiliated companies	3,128,000		
Land	337,000	148,000	136,000
Buildings, machinery and other property	7,927,000	4,026,000	581,000
Less—reserve for depreciation	2,163,000*	481,000*	382,000*
Prepaid and deferred charges	233,000	17,000	19,000
Total assets	$20,161,000	$7,135,000	$3,252,000
Liabilities			
Notes and accounts payable:			
Trade	$ 3,384,000	$2,338,000	$ 851,000
Intercompany	480,000	102,000	627,000
Accrued liabilities	600,000	79,000	64,000
20-year 6% serial bonds	4,800,000		
Capital stock—6% cumulative preferred	4,000,000		1,000,000
Capital stock—common	4,000,000	3,000,000	10,000
Earned surplus	2,897,000	1,616,000	700,000
Total liabilities	$20,161,000	$7,135,000	$3,252,000

* Denotes red.

Summary of profit and loss accounts for the year ended December 31, 1935

Income	XYZ Corporation	Manufacturing Company	Distributing Company
Sales and revenue from services:			
Outside	$ 6,721,000	$4,160,000	$5,247,000
Intercompany	4,252,000	2,921,000	175,000
Dividends and other income received	324,000	173,000	84,000
Total income	$11,297,000	$7,254,000	$5,506,000
Expenses			
Cost of sales and services	$ 7,829,000	$5,228,000	$3,714,000
General, administrative and selling expense	1,336,000	824,000	1,032,000
Taxes	414,000	140,000	87,000
Depreciation	382,000	153,000	28,000
Other expenses	514,000	562,000	213,000
Total expense	$10,475,000	$6,907,000	$5,074,000
Net profit	$ 822,000	$ 347,000	$ 432,000

During your examination of the accounts, the following facts are learned:

The XYZ Corporation investment in stocks of affiliates consisted of the following:

Company	Class	Number of shares	Cost
Manufacturing Company..............	Common	18,000	$2,060,000
Distributing Company..	Common	800	8,000
Distributing Company..	6% cumulative preferred	8,000	960,000
Development Company.	Common	1,000	100,000
Total..			$3,128,000

Manufacturing Company was organized in 1930 by XYZ Corporation and certain XYZ Corporation officers and stockholders, XYZ Corporation purchasing 40 per cent of the Manufacturing Company stock at par. Although XYZ Corporation at that time did not have stock control of Manufacturing Company, control of the affairs of the latter company was effected through identical managerial staffs. During 1935, XYZ Corporation purchased an additional 20 per cent of the stock of Manufacturing Company at a cost of $860,000, which was also the book value of the equity as shown by the subsidiary's records on that date. At December 31, 1935, it was decided to include the accounts of Manufacturing Company in the consolidation of the accounts of XYZ Corporation and its subsidiaries, although up to that time Manufacturing Company accounts had not been so included.

Additional Distributing Company stock had been received by XYZ Corporation during the year 1935 through the recapitalization of Distributing Company. Prior to the recapitalization, the holdings of XYZ Corporation in the stocks of Distributing Company had consisted of 800 common shares having a par value of $10 and 3,200 preferred shares having a par value of $100 per share. The cost of these stocks had been $8,000 and $960,000, respectively. At the date of acquisition, XYZ Corporation equity in Distributing Company earned surplus account, as represented by these purchases, was $640,000. The common stock carried voting rights only, having no equity in earnings and being restricted to the receipt of $10 per share upon liquidation or dissolution. The preferred stock was nonvoting but was

entitled to receive all distributions from surplus through dividends or otherwise, and in liquidation or dissolution it was provided that the preferred stockholders should receive distributions to the extent of the par value of their share holdings prior to any distribution to the common stockholders.

On June 1, 1935, the stockholders of Distributing Company unanimously agreed to a plan of recapitalization wherein the preferred stockholders surrendered their shares and for each share surrendered received in exchange therefor two and one-half shares of 6 per cent-cumulative preferred stock having a par value of $100 per share. It was also provided that upon dissolution or liquidation the new preferred stockholders should receive $100 per share plus accumulated unpaid dividends prior to any distributions to the common stockholders. The common stockholders exchanged their old stock share for share for new stock having the same par value and voting rights but entitled to dividends, provided that there were no dividends in arrears on the preferred stock. The common stock was also entitled to all distributions made upon dissolution or liquidation after the payments required to satisfy the preferred-stock provisions.

The increase in the aggregate par value of preferred stock was reflected in the accounts of Distributing Company by a charge to earned surplus and a corresponding credit to capital account. XYZ Corporation did not make any entries to record the transaction in its accounts.

You are informed that the investment in the capital stock of Development Company represents 100 per cent ownership of that company. The company was formed to develop certain new manufacturing processes and as yet has not entered upon production. The company does not report profit or loss, charging all expenditures to development account. You are told that the accounts of this subsidiary are not to be included in the consolidated accounts. Officers of XYZ Corporation represent to you that the subsidiary is not indebted to anyone other than to XYZ Corporation and that the amount charged to development account at December 31, 1935, was $135,000.

The capital stock outstanding at December 31, 1935, was as shown at the top of page 264.

All of the foregoing shares had a par value of $100 except the $10 par-value common shares of Distributing Company.

Company	Class	Number of shares issued and outstanding
XYZ Corporation..........	6% cumulative preferred	40,000
XYZ Corporation..........	Common	40,000
Manufacturing Company....	Common	30,000
Distributing Company.......	6% cumulative preferred	10,000
Distributing Company.....	Common	1,000

XYZ Corporation paid two quarterly dividends in 1935, constituting payment of all preferred dividends accumulated to July 1, 1935. Distributing Company paid two quarterly dividends on its new preferred shares, disposing of dividends on that stock to November 30, 1935. In addition, Distributing Company paid a dividend of $100 per share on its new common stock on November 1, 1935. All dividends received by XYZ Corporation have been credited to income.

Included in intercompany accounts receivable of XYZ Corporation is an amount of $50,000 owing from Development Company.

The twenty-year six per cent serial bonds mature $400,000.00 annually on July 1.

Consolidated earned surplus balance at December 31, 1934, was $2,353,400.

You are instructed to submit consolidating working papers and journal entries necessary to prepare a consolidated balance-sheet and summary of consolidated profit and loss account. It is suggested that your working balance-sheet and profit and loss account be prepared as in the preceding tabulation, allowing one column for each company and arriving at a combined total. Immediately to the right of the "combined" column should be two columns, debit and credit, for the posting of journal entries, and to the right of these two columns should be a column "consolidated, as adjusted."

Journal entries to effect elimination should be assigned letters to distinguish them in the journal-entry columns.

In addition, you should prepare an analysis of consolidated surplus account for the year 1935.

Also indicate such footnotes or explanatory data as you would place on the consolidated balance-sheet and profit and loss account if you were required to submit a report for distribution to investors and creditors.

PART IV

SPECIAL PROBLEMS

SECTION XVI

BANKS, BROKERAGE AND FOREIGN EXCHANGE

Problem 130

(New York, June, 1932)

From the following information concerning the 12 Federal Reserve banks, prepare statement of resources and liabilities as of February 11, 1931, omitting ciphers:

Foreign bank deposits	$ 5,306,000
Reserves other than gold	176,855,000
Bills bought in open market	87,739,000
Capital paid in	169,296,000
Bank premises	58,098,000
Deferred availability items	435,473,000
Gold and gold certificates held by banks	820,081,000
Bills discounted secured by U. S. Government obligations	79,396,000
Surplus	274,636,000
U. S. Government bonds	80,906,000
Due from foreign banks	711,000
Uncollected items	444,122,000
Nonreserve cash	76,649,000
Other bills discounted	142,793,000
Member-bank-reserve accounts deposits	2,364,686,000
Federal Reserve notes of other banks	17,785,000
All other liabilities	12,741,000
Gold with federal reserve agents	1,752,459,000
U. S. Government treasury notes	192,121,000
All other reserves	19,243,000
Federal Reserve notes in actual circulation	1,481,006,000
Gold redemption fund with U. S. Treasury	34,467,000
U. S. Government certificates and bills	336,593,000
Gold settlement fund with Federal Reserve Board	470,484,000
Other deposits	18,445,000
Government deposits	28,913,000

Problem 131

(American Institute of Accountants, May, 1931)

From the items following, prepare a detailed statement of the condition of the X Bank and Trust Company as at the close of business on December 31, 1930.

The balance applicable to undivided-profits account must be determined by the candidate.

Acceptances anticipated	$ 45,000
Acceptances outstanding	425,000
Bank premises	1,250,000
Bonds—other than U. S. government	2,750,000
Capital stock	3,000,000
Cash on hand	600,000
Certificates of deposit	250,000
Certified cheques	125,000
Christmas clubs	171,000
Commercial deposits	6,250,000
Coupon deposits	20,000
Customers' liability for acceptances executed	425,000
Demand collateral loans	2,375,000
Discounts	4,500,000
Dividend payable January 1, 1931	30,000
Due from Federal Reserve bank	1,000,000
Due from sundry banks	350,000
Due to banks	585,000
Exchanges for clearing house	200,000
Federal Reserve bank stock (50% of subscription)	100,000
Furniture and fixtures	100,000
Interest receivable accrued	5,000
Letters of credit—customers' liability	50,000
Letters of credit executed for customers	50,000
Miscellaneous real estate	75,000
Official cheques	46,000
Overdrafts	4,000
Real-estate loans	6,250,000
Rediscounts	1,250,000
Reserve for contingencies	225,000
Reserve for interest, taxes and other expenses	60,000
Savings deposits	8,750,000
Securities borrowed	250,000
Stock—other than Federal Reserve bank stock	175,000
Surplus	1,500,000
Time collateral loans	3,025,000
Undivided profits (?)	
Unearned discount	40,000
United States government bonds	1,250,000
United States government bonds pledged	250,000
United States Postal Savings deposits	115,000

Problem 132

(Pennsylvania, November, 1931)

A. B. and Company, stockbrokers, failed several months ago, and a plan has now been proposed by which another firm of stockbrokers is to assume the customers' accounts. The Standard Statistics Stock Market Average of listed stocks was $125 per share at the date of the failure as compared with $110 per share at the present time, and it is believed that the securities sold by banks to liquidate the loans of the firm can be repurchased at prices equivalent to the present average.

The receiver and the interested brokers have agreed as follows:

1. Allowances for unsecured and partially secured accounts as recorded at present are believed sufficient to cover losses.
2. Appraised values of the following security accounts need not be considered, as any losses arising therefrom will be claimed against the stock exchange memberships:

   Stock loaned.
   Failures to receive.
   Miscellaneous assets.
   Securities borrowed.
   Failures to deliver.
   Miscellaneous liabilities.

3. Securities are to be repurchased to cover liabilities to customers and for due bills outstanding.
4. The price averages for bonds will be considered the same as for stocks.
5. It is believed that customers will make delivery in kind of the securities required to close their short positions.
6. A loss of $30,000 is anticipated from the deposits in closed banks.
7. The receiver will make no estimate of receivership expenses, as he states that he has no definite information as to possible syndicate claims.

A schedule of the assets and liabilities prepared by the receiver and giving effect to the adjustments he has found it possible to make and including appraised values as at the date of the failure is as follows:

Schedule of assets and liabilities

Assets

Cash on hand and in banks (including $74,200 on deposit in banks in the possession of the State Banking Department)	$ 286,680.59	
Stock transfer stamps	2,342.10	$ 289,022.69
Customers' debit balances:		
Fully secured by securities appraised at $5,412,192.34	$3,065,599.68	
Partially secured by securities appraised at $25,334.19 but protected by guarantees of other customers having sufficient equities	66,103.94	
Partially secured by securities appraised at $161,335.17	88,724.55	
Partially secured by securities appraised at $6,605.13, debit balances reduced by prior write-downs to	7,729.30	
Unsecured	11,621.10	
	$3,339,778 57	
Less allowance for unsecured and partially secured accounts with deficits	37,500.00	3,302,278.57
Bills receivable:		
Fully secured by securities appraised at $250	$ 188.23	
Partially secured by securities appraised at $567.46	883.96	
Unsecured	22,255.71	
	$ 23,327.90	
Less allowance for unsecured and partially secured accounts	22,500.00	827 90
Forward		$3,592,129.16
Appraised value of securities on hand or receivable (including those which were from investments):		
In box and transfer (exclusive of securities held for safekeeping)	$ 993,138.83	
Excess collateral on loans after liquidation of loans payable	866,497.69	
Due from customers on short sales	171,733.90	
Stocks loaned	168,293.75	
Failures to receive	39,684.14	
Miscellaneous	1,419.55	2,240,767.86
Due from brokers on account of securities borrowed	$ 68,200.00	
Due from brokers on account of failures to deliver	28,815.55	97,015.55

Advances to salesmen, etc		$ 533.69
Due from Stock Clearing Corporation		299.37
Dividends claimed		6,921.56
Estimated value of memberships, New York and Philadelphia Stock Exchanges, ledger values $420,000, subject to claims of members		300,000.00
		$6,237,667.19
Excess of liabilities over assets, before provision for expenses of receivership, loss arising from liquidation of securities, syndicate and open contracts, etc		313,898.77
Total		$6,551,565.96
Liabilities		
Customers' free credit balances	$ 93,976.71	
Checks outstanding	65,891.31	
Deposits subject to check	23,635 90	$ 183,503.92
Appraised value of security liability:		
Due to customers without debit balances	$ 173,257.03	
Due to customers with debit balances	5,605,466.83	
Due to customers on account of bills receivable	817.46	
Securities borrowed	67,618.75	
Failures to deliver	24,570.18	
Against due bills outstanding	8,104.22	
Miscellaneous	2,931.13	5,882,765.60
Forward		$6,066,269.52
Customers' credit balances arising from short sales, fully secured	$ 182,740.90	
Customers' credit balances arising from short sales, partially secured, value of securities short $4,220.87	4,130.05	186,870.95
Stocks loaned	$ 175,550.00	
Fail to receive	46,379.03	221,929.03
Unclaimed dividends and securities		30,829.95
Claims made by brokers for losses incurred in buying or selling under the rule, etc.		16,258.47
Allowance for general expenses and commissions payable to salesmen		29,408.04
Liabilities to customers and others, excluding capital account of limited partner, all accounts of general partners and syndicate and subordinated liabilities		$6,551,565.96

Required. Prepare a statement showing the computation of the revised deficit after giving effect to the proposed plan.

Prepare a letter to the receiver showing the revised deficit, this letter to be used by him as an exhibit to support his representations to the federal court that the proposed plan is feasible.

Problem 133

(American Institute of Accountants, May, 1935)

The U. S. A. Company, a domestic corporation, purchased on January 1, 1931, a 90% interest in the capital stock of X Company, Limited, an English corporation, for the sum of $550,000. The U. S. A. Company acquired a further 5% interest in X Company, Limited, on June 30, 1932, for $25,000.

The following is a summary of the position of X Company, Limited, as shown by the reports of the local auditors:

	1931 January 1	1931 December 31	1932 December 31	1933 December 31
Current assets	£100,000	£110,000	£115,000	£125,000
Current liabilities:				
To U. S. A. Company	4,000	6,250	6,000	4,000
(due in dollars)	($ 20,000)	($ 25,000)	($ 21,000)	($ 20,000)
To others (due in sterling)	£ 36,000	£ 58,750	£ 69,000	£ 61,000
	£ 40,000	£ 65,000	£ 75,000	£ 65,000
Net current position	£ 60,000	£ 45,000	£ 40,000	£ 60,000
Fixed assets—less reserves	£ 75,000	£ 70,000	£ 65,000	£ 65,000
Funded debt	20,000	20,000	20,000	20,000
Net fixed position	£ 55,000	£ 50,000	£ 45,000	£ 45,000
Total equity	£115,000	£ 95,000	£ 85,000	£105,000
Capital stock	£100,000	£100,000	£100,000	£100,000
Earned surplus*:				
Balance, January 1st	£ 15,000	£ 15,000	£ *5,000*	£ *15,000*
Profit or *loss* for year		*15,000*	*10,000*	20,000
Dividend paid June 30th		*5,000*		
	£ 15,000	£ *5,000*	£ *15,000*	£ 5,000
Total capital and surplus	£115,000	£ 95,000	£ 85,000	£105,000
Note:				
Earned surplus, June 30, 1932			£ *10,000*	
Exchange rates				
On balance-sheet dates	5	4	3.50	5
On June 30th		5	4	

* Italics indicate red figures.

Prepare:

1. A columnar statement whereon the U. S. A. Company's entries to its investment and surplus accounts are shown. Give full explanations on the statement.

2. A statement of revenue surplus showing the ultimate profit or loss on exchange with proper explanation of how it came about.
3. State briefly in what manner the exchange risks could have been averted.

Problem 134

(American Institute of Accountants, May, 1932)

You are retained to audit the accounts of the S Manufacturing Company for the year ended December 31, 1931. Prepare a balance-sheet, in proper form, as at the close of that year, for submission to your client.

You are furnished with the trial balance from the company's books, as of December 31st, as follows:

	Dr.	Cr.
Cash in bank	$ 111,869.50	
Customers' notes	17,625.75	
Customer's accounts	228,429.20	
Reserve for bad debts		$ 21,610.25
Inventories	496,267.50	
Due from Canadian branch	30,000.00	
Unexpired insurance	11,350.10	
Common stock held in treasury (1,400 shares)	118,200.00	
Land	28,000.00	
Buildings	225,000.00	
Machinery and equipment	150,400.00	
Furniture and fixtures	22,600.00	
Reserve for depreciation		46,225.50
Patents	34,000.00	
Bond discount and expense	24,000.00	
Bank loan		20,000.00
Accounts payable		37,150.00
Accrued wages		1,100.00
Accrued local taxes		4,000.00
First-mortgage, 6 per cent bonds		450,000 00
Preferred, 6 per cent stock ($100 par)		250,000.00
Common stock ($100 par)		400,000.00
Surplus		279,893.80
Profit and loss		2,762.50
Dividends on preferred stock	15,000.00	
Totals	$1,512,742 05	$1,512,742.05

In the course of the audit, you obtain the following information:

(1) The first-mortgage, 6 per cent bonds were issued February 1, 1929, and mature February 1, 1939. Interest is payable February 1st and August 1st, and has been entered on the books as paid. There has been no change in the bond-discount-and-expense account since the issuance of the bonds.
(2) The land and buildings are carried at appraised values, which are $48,500 more than cost. The adjustment to appraised values was credited to surplus in 1929.
(3) Included in customers' accounts is an account with the president of the company showing that he owes $24,750 for advances, less salary and other credits, and that he has consistently owed from $20,000 to $25,000 throughout the year.
(4) Beginning February 15, 1932, and annually thereafter, the company is obligated to deposit $25,000 in a sinking fund for retirement of the bonds.
(5) The regular quarterly dividend on the preferred stock was declared December 15, 1931, payable January 2, 1932.
(6) The company has discounted customers' notes aggregating $64,000.
(7) The Canadian branch was opened during the year. A trial balance from the books of the branch, at December 31, 1931, was as follows:

Cash	$10,000	
Accounts receivable	18,000	
Inventory	12,000	
Accounts payable		$10,000
Due to home office		30,000
Totals	$40,000	$40,000

The rate of Canadian exchange, at the date of the balance-sheet, was 85.
(8) The patent account represents the cost of rights to manufacture a certain device. The rights were acquired in June, 1930, to run for seventeen years.

Problem 135

(American Institute of Accountants, November, 1936)

The Parent Corporation, engaged in manufacturing and selling its products in the United States, organized a foreign subsidiary, called The English Company, in London, and one called The French Company in Paris, both as of December 31, 1934. The balance-sheets of The Parent Corporation as at December 31, 1935, and of the two foreign companies as at November 30, 1935 (the end of their fiscal years), together with statements of surplus for the year ended on those dates, are given below:

	The Parent Corporation Dec. 31, 1935	The English Company Nov. 30, 1935	The French Company Nov. 30, 1935
Assets	($)	(£)	(Fcs.)
Cash	241,016	15,013	12,008
Accounts receivable	313,849	17,927	28,695
Inventories	726,615	37,324	40,370
Investment in stock of The English Company—20,000 shares at cost	98,400		
Advanced to The English Company	78,781		
Investment in stock of The French Company—500 shares at cost	3,300		
Advances to The French Company	14,900		
Capital assets, less reserves	906,442		
Fixtures and equipment, foreign companies, less reserves		3,800	17,720
Deferred charges	19,861	838	1,026
Totals	2,403,164	74,902	99,819
Liabilities			
Accounts payable	378,414	21,107	42,767
Dividend payable Jan. 15, 1936		2,000	
Due to The Parent Corporation (U. S. dollar liability)		18,263	16,610
Capital stock—			
15,000 shares of $100 each	1,500,000		
20,000 " " £1 "		20,000	
500 " " Fcs. 100 each			50,000
Surplus (*deficit) as below	524,750	13,532	9,558*
Totals	2,403,164	74,902	99,819

Surplus	($)	(£)	(Fcs.)
Profit (*loss) from operations..	281,125	17,912	7,786*
Dividend received from The English Company (£2,000)	9,880		
Total....................	291,005		
Less—Provision for depreciation..............	62,101	380	1,772
Net profit (*loss) for the year...............	228,904	17,532	9,558*
Surplus at beginning.........	400,846		
Total....................	629,750	17,532	9,558*
Dividends paid...............	105,000	4,000	
Surplus (*deficit) at end.	524,750	13,532	9,558*

The rates of exchange in effect at various dates during the year are stated below:

In effect	English pounds	French francs
Dec. 1, 1934..........	4.92	6.6
Jan. 1, 1935..........	4.93	6.6
Feb. 1, 1935..........	4.94	6.6
Mar. 1, 1935..........	4 94	6.6
Apr. 1, 1935..........	4.95	6.3
May 1, 1935..........	4.95	5.8
June 1, 1935..........	4.94	5.8
July 1, 1935..........	4.96	6.0
Aug. 1, 1935..........	4.95	6 0
Sept. 1, 1935..........	4.97	6.0
Oct. 1, 1935..........	5.08	6.0
Nov. 1, 1935..........	5.06	6.1
Dec. 1, 1935..........	5.02	6.2
Average 1935..........	4.97	6.2

The following statement shows the depreciated values on November 30, 1935, of the fixtures and equipment acquired by the foreign companies on the dates given therein:

	The English Company (£)	The French Company (Fcs.)
December 1, 1934..........	2,400	10,200
June 16, 1935..........	1,000	5,000
August 8, 1935..........	400	2,520
Totals..........	3,800	17,720

The advances to foreign companies, as shown by The Parent Corporation's accounts, are summarized as follows:

	The English Company	The French Company
Balance, November 30, 1935	$ 90,875	$ 998
Add—Shipments in December, 1935, at billing prices (cost 20% less)	13,026	8,902
Cash advanced		5,000
Total	$103,901	$14,900
Deduct—Cash received	'25,120	
Per balance-sheet	$ 78,781	$14,900

The inventories of foreign companies were purchased partly from The Parent Corporation and partly locally, as follows:

	The English Company (£)	The French Company (Fcs.)
Purchased from The Parent Corporation at billing prices	32,106	28,546
Purchased locally	5,218	11,824
Per balance-sheet	37,324	40,370

The cost to The Parent Corporation of the merchandise sold to foreign companies and remaining in the inventories at November 30, 1935, was as follows:

The English Company	$119,736
The French Company	1,361

Prepare a consolidation statement under date of December 31, 1935, showing conversion rates used. Computations and adjustments should be made to the nearest dollar.

Problem 136

(American Institute of Accountants, November, 1933)

You are appointed by the board of directors to examine the accounts relating to the assets and liabilities of The Goodenough Corporation, New York, and its domestic subsidiaries, as at December 31, 1932.

Prepare a consolidated balance-sheet as at December 31, 1932.

The Goodenough Corporation has one foreign subsidiary (wholly owned), the accounts of which have been examined by another firm of accountants whose report, which has been submitted to you, is as follows:

THE BRITISH GOODENOUGH COMPANY, LTD.
Balance-sheet as at December 31, 1932
Liabilities

Share capital:		
Authorized:		
600,000 shares of £1 each	£600,000	
Issued:		
600,000 shares of £1 each		£600,000
Current trade liabilities		78,500
Reserve for income tax payable:		
Due January 1, 1933		90,000
Due January 1, 1934		74,500
Indebtedness to affiliated company		2,500
Profit-and-loss appropriation account:		
Balance January 1, 1932	£ 12,145	
Net profit for year	298,000	
Total	£310,145	
Less: Dividends	200,000	110,145
Total		£955,645

NOTE.—There is a liability not included in this balance-sheet in respect to machinery which this company has agreed to purchase.

Assets

Property, plant and equipment at cost, less reserve of £250,000 for depreciation	£450,000
Stock on hand at cost	170,000
Customers' accounts receivable, less reserve of £10,000 for bad and doubtful accounts	250,383
Cash at bank and in hand (Of this amount the sum of £80,000 is earmarked for a guarantee given on behalf of the company)	85,262
Total	£955,645

Auditor's report

We report to the members that we have examined the above balance-sheet with the books of the company and have obtained all the information and explanation we have required. We are not satisfied as to the adequacy of the reserve for bad and doubtful accounts.

Subject to this remark we are of opinion that the balance-sheet is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs as at December 31, 1932, according to the best of our information and explanations given to us, and as shown by the books of the company.

A. B. C. AND CO.

London, England,
January 31, 1933

You have communicated with the English company and with its auditors and have ascertained the following:

(a) With the exception of machinery costing £100,000, which was installed in November, 1932, when the average rate of exchange was $3.50, the property, plant and equipment were acquired when the company was formed, when the rate of exchange was at par ($4.86). The established policy of the company is to charge a full year's depreciation on additions made in the first six months of any year and to charge depreciation commencing January 1st of the year following the year of addition on additions made in the second six months of any year.

(b) Of the stock on hand £160,000 represents goods purchased from The Goodenough Corporation, the parent company, at its cost of $540,000 plus freight to England of $36,000 paid by the parent company at the time of shipment. Cost of the remaining £10,000 of British stock approximated market at December 31, 1932. (Note: There had been no change in freight rates to December 31, 1932, and the rate of exchange on that date was $3.40. You find that The Goodenough Corporation had reduced the cost of its inventory by 10% in order to reflect the lower of cost or market value as at December 31, 1932. The directors have agreed that for the purpose of the consolidated balance-sheet the inventory as a whole should be valued at the lower of cost or market value.)

(c) The auditors of The British Goodenough Company, Ltd., feel that an additional reserve of £50,000 should be provided against the accounts receivable. Neither the directors of the British company nor those of the American corporation can agree that any further reserve is necessary.

(d) The note on the British balance-sheet refers to machinery which it has been agreed shall be purchased from the parent company at its cost less depreciation—net $120,000.

As a result of your examination of the accounts of The Goodenough Corporation and its domestic subsidiaries, you have prepared the following consolidated trial balance as at December 31, 1932, together with your list of audit notes:

Consolidated trial balance as at December 31, 1932

	Dr.	Cr.
Cash in banks and on hand	$ 880,000	
U. S. government securities	504,000	
Accounts receivable	1,910,000	
Reserve for doubtful accounts		$ 210,000
Inventories	1,325,000	
Property, plant and equipment	6,600,000	
Reserve for depreciation		2,500,000
Company's own shares	275,000	
Due from The British Goodenough Company, Ltd	10,000	
Accounts payable and accrued liabilities		2,320,000
Provision for federal income tax		275,000
Dividend of 50 cents a share payable Jan. 2, 1933		500,000
Capital stock—common, no par, authorized and issued		5,000,000
Surplus		3,615,000
Investment in subsidiary company at cost	2,916,000	
Totals	$14,420,000	$14,420,000

Audit notes

(1) Cash includes a special deposit of $100,000 in the Y Bank & Trust Company. This deposit is subordinate to claims of all other depositors but not to claims of stockholders.

(2) The government securities are stated at cost, although the market value at December 31, 1932, was only $490,000. However, on February 28, 1933, the market value had recovered to $507,000.

(3) The inter-company account is debited or credited at the actual rate of exchange on the date of each transaction, but the balance at the end of each month is adjusted on the books of the parent company by a debit or credit to profit-and-loss account, to bring the account to the basis of a fixed rate of exchange, viz., $4. The actual dollar cost of the £2,500 shown on the British company's balance-sheet was $9,250. There were no items in transit.

(4) In addition to customers' accounts the following items are included in accounts receivable:

(a) Loan to officer $87,000.

(b) Customers' accounts aggregating $370,000, on which payments are deferred by special arrangement until 1934: $50,000 of reserve is allotted to these accounts.

(5) Company's own shares represent 7,000 shares carried at cost and held for resale to employees under employees' stock purchase plan. The market value on December 31, 1932, was $3 per share but the directors will not agree to writing down this asset to market value.

(6) The life of Mr. B., President, is insured for $1,000,000 in favor of the company and the policy at December 31, 1932, had a cash-surrender value of $75,000. All premiums have been charged to expense, as the directors object to setting up cash-surrender value on the books.

(7) There are claims pending against the company which are estimated not to exceed $150,000.

(8) The property, plant and equipment accounts are stated at cost.

(9) Accounts payable include employees' savings deposits, $392,999.

SECTION XVII

BUDGETS

Problem 137

(New York, October, 1937)

From the following data, prepare a statement showing, by months, the cash requirements of an instalment dealer for the first year's operations, assuming that no inventories are carried:

Cost of article	$50
Sales price	90
Selling expense	15
General expense	15
Profit	10

Sales for first month—100 articles.
Sales for second month—200 articles.
Sales for each subsequent month—300 articles.
Payments $10 down and $10 per month.
(Assume no irregularities.)
Merchandise is paid for in the month following the sale.
Expenses are paid in the month of the sale.

Problem 138

(New York, April, 1937)

On the basis of the following, prepare an estimated profit and loss statement of the XYZ Store for the ensuing year:

Rate of merchandise turnover is 8, based on opening inventory of $48,000.

Final inventory is to be $45,000.

There will be a 10 per cent decline in wholesale prices applicable throughout the entire year.

Purchase returns are 1.03 per cent of gross purchases.

Cost of purchases computed on foregoing basis included inward carrying charges of 3 per cent of the full cost of such purchases.

The average gross profit is 40 per cent of net sales.
Sales returns and allowances are 3 per cent of gross sales.
Selling expenses are 18 per cent.
Administrative expenses are 13 per cent.
Financial expenses are 3 per cent.
Financial income is 2 per cent.

Problem 139

(Ohio, May, 1936)

On January 1, 1936, the audited balance-sheet of The Cincinnati Manufacturing Company was as follows:

Assets	
Cash on deposit	$ 25,000
Accounts receivable	60,000
Inventory—finished products, 40,000 units	280,000
Plant and equipment	150,000
Total	$515,000
Liabilities	
Accounts payable for equipment—due January 20, 1936	$ 20,000
Accounts payable—3 months at $50,000—terms 60 days	150,000
First-mortgage 6% bonds—due January 1, 1936, and accrued interest	103,000
Reserve for depreciation	12,000
Reserve for bad debts	790
Capital stock	200,000
Surplus	29,210
Total	$515,000

Owing to the maturity of the equipment accounts payable and the fact that the first-mortgage bonds, and the October accounts payable are past due, the company requested a six months' bank loan of $250,000 to pay these obligations and to supply additional working capital. Six per cent interest to be paid at maturity of loan.

In order to show the bank that the loan could be repaid at the end of six months, the budget officer submitted the following data from which you were requested to prepare a monthly cash statement and a monthly income and expense statement.

Sales and production estimate—six months:	Sales	Production
January, 1936	25,000 units	17,000 units
February, 1936	64,000 units	56,000 units
March, 1936	16,000 units	13,000 units
April, 1936	24,000 units	23,000 units
May, 1936	52,000 units	48,000 units
June, 1936	19,000 units	23,000 units

Cost of production estimate—six months:

Raw materials	$720,000
Direct labor	270,000
Variable overhead	252,000
Fixed overhead	12,000
Depreciation—factory	6,000

Selling and administrative expense estimate—6 months:

Total, excluding bad debts	$200,000

According to past experience, collections each month equal 95 per cent of previous month's sales; 4 per cent are collected in the following month, and 1 per cent are lost. The sales for November, 1935, amounted to $20,000; and for December, 1935, $59,000. The usual selling price per unit of $10 will be maintained.

Purchase commitments had been made for the entire six months' raw material requirements; shipments of $270,000 to be received the first month, and the balance in equal monthly instalments; invoices to be rendered by the vendors at date of shipments; terms 60 days net.

Selling and administrative expenses, of which the largest single item is for commissions, will retain a fixed relation to sales. The direct labor and variable overhead will be influenced by production. The liabilities for selling, administrative, overhead expenses and direct labor will be paid during the months incurred. All goods put into production will be completed by June 30.

Disregard income tax.

Problem 140

(Ohio, November, 1935)

Certain persons are considering leasing a foundry on January 1, 1936, at $60,000 for a three-year term (50 per cent payable January 1, 1936; 30 per cent January 1, 1937; and 20 per cent January 1, 1938) for manufacture of an automotive product, with assurance of a contract for the entire output for this period at a firm price of 70 cents per unit.

Reliable engineers estimate annual production and delivery as follows:

1936	120,000 units
1937	240,000 units
1938	300,000 units

Shipments will be made in uniform monthly amounts, and payment will be made on the tenth of the following month.

Each unit upon completion will weigh four pounds. The metal loss in machining the rough castings is 5 per cent, which is salvaged as scrap. It is estimated that 10 per cent of the rough castings will be defective.

All scrap is accumulated during each month and used in the following month's melting. Consider scrap as worth $10 a ton. Scrap on hand at termination of contract is to be sold at that price.

Pig iron will be purchased locally at $20 per ton, and a quantity should be on hand at end of each month sufficient to meet the following month's production, exclusive of scrap inventory.

The melting loss will run 6.433 per cent; *i.e.*, the weight of rough castings will be 6.433 per cent less than the weight of metal in each melting.

In the melting of each ton of metal there will be required 1/6 ton of limestone, costing $2 a ton, and 3/4 ton of coke, costing $4 per ton, delivered.

The molding will be done by hand at a fixed rate of 10 cents for good castings. Other estimated expenses of the first year are:

Melting labor and expense	$2,000
Molding expense (exclusive of labor)	3,000
Core-making labor and expense	2,000
Cleaning and finishing expense	2,000
Miscellaneous materials and expense	1,000
Indirect labor	1,000
Electric current	300
Insurance	500
Shipping expense	500
Administrative expense	5,000

During succeeding years these expenses, except administrative and insurance, will vary with production.

It will be necessary at the outset to invest $150,000 in special equipment which you may assume will have no salvage value upon completion of the contract.

You have been employed to determine what amount of capital will be required to finance the contract and what amount of profits may be expected from the venture; also make a comparative annual statement of estimated profit and loss for the three years.

NOTE.—Show all amounts to the nearest dollar, and disregard federal income and excess profits taxes.

Problem 141

(Ohio, May, 1934)

The Allegheny Power Company has constructed a power plant on the Ohio River and is receiving bids for a fuel supply for five years beginning January 1, 1935. A group of capitalists by whom you are employed is interested in obtaining this contract.

The power company proposes to purchase the following quantities of coal and agrees to make payments therefor on the dates of shipment:

1st year	184,000 tons	4th year	336,000 tons
2d year	200,000 tons	5th year	500,000 tons
3d year	280,000 tons		

A tract of land containing 1,500,000 tons of coal can be purchased for $75,000, and it is estimated that $115,000 will be required to build a tipple and tracks, to acquire mining equipment and make an opening to the face of the coal deposit. The mine would have no value after the coal is exhausted, but the tipple, tracks and equipment could be salvaged for 10 per cent of their initial cost. The "straight-line" method of depreciation would be used.

During the first year, coal can be removed most economically, as it is located nearest the tipple; but as operations extend farther into the mine, expenses will increase by reason of longer haulage, extension of drainage, ventilation and additional equipment. Regardless of this condition, the expenditure for supplies, transportation, repairs, electric current, etc., amounting to $27,600 in

the first year, will increase in proportion to production, and, by reason of the condition stated, the otherwise normal expense will be increased as follows: Taking the first year as a base, *i.e.*, 100 per cent, the expense of the second year will be 101 per cent, third year 102 per cent, fourth year 102½ per cent and fifth year 104 per cent. This progressive increase is caused solely by the recession of the working area irrespective of the normal increase caused by larger production. Operating expenses for the first year are estimated as follows:

Mining cost—labor and other direct charges	$92,000
Supplies, transportation, repairs (including equipment replacement and extensions), electric current, drainage, ventilation, etc	27,600
Administrative and general expense (annual non-variable)	20,220

Your clients are willing to advance $100,000 cash capital and can sell at 90 an issue of 6 per cent sinking-fund bonds dated January 1, 1935, for whatever additional capital is required. Interest would be payable on December 31 of each year, and payments into the sinking fund would be required at the same time on a tonnage basis, without interest, necessary to retire the issue when the coal deposit is exhausted.

By reason of its inability to consume greater tonnage in the earlier years, the power company is willing to pay a higher price on its earliest purchases, and it has been agreed that the contract price (f.o.b. mine) shall be scaled as follows:

1st year	base price per ton
2d year	90% of base price per ton
3d year	80% of base price per ton
4th year	75% of base price per ton
5th year	72% of base price per ton

Income taxes upon annual profits will be payable at the rate of 12½ per cent during each succeeding year.

At what base price must the coal be sold in order that your clients may, upon completion of the contract, be assured of a net profit of 175 per cent upon their capital investment, such profit to be distributed annually during the period of operation? Submit a budget of cash and operations to support your conclusions.

Problem 142

(Ohio, November, 1932)

You have been employed by the Columbus Specialty Company to prepare a *forecast* of its operations for the period ending July 31. From the information given, prepare a cash statement, monthly (April–July) income and expense statement in columnar form and balance-sheet as it should appear on July 31.

Balance-sheet, March 31

Assets	
Cash on deposit	$ 24,820
Accounts receivable	69,600
Inventory of raw material	27,000
Buildings, machinery and equipment	135,000
Prepaid insurance	3,300
Total	$259,720
Liabilities	
Note payable (special 6% loan)	$ 30,000
Accounts payable	51,300
Accrued payroll	12,500
Accrued interest and taxes	3,300
Depreciation reserve	2,700
Capital stock	140,000
Surplus	19,920
Total	$259,720

Income and expense
Three months ended March 31

Sales (60,000 units)		$180,000
Material consumed	$60,000	
Direct labor	36,000	
Overhead	36,000	132,000
Gross profit		$ 48,000
Administrative expense	$15,000	
Selling expense	9,000	24,000
Balance		$ 24,000
Cash discounts	$ 1,080	
Depreciation	2,700	
Interest	300	4,030
Net profit		$ 19,920

Buildings and equipment are wholly used in manufacturing, depreciation being provided on straight-line basis. $15,000 of

new machinery will be purchased in July. Depreciation charges will be as follows: April, May, June, $1,000 each; July, $1,060.

Thirty per cent of current month's sales are paid within the same month and are allowed 2 per cent cash discount; 60 per cent are paid during the following month; 8 per cent in the second month and balance may be considered uncollectible. No provision has been made for losses arising from uncollectible accounts.

Accounts payable are due on the tenth of each month for all purchases and expenses of previous month including administrative and selling. Payrolls are payable on the fifth and twentieth of each month for preceding half calendar-month periods.

Company's credit permits loans in multiples of $10,000 for full calendar months only, with interest deducted at 6 per cent per annum. Special-term note outstanding March 31 is dated February 1, due in four months.

The sales department estimates the following monthly requirements and recommends certain additional production to establish a reserve for future demands:

	Sales	Production
January (actual)	10,000 units	10,000 units
February (actual)	20,000 units	20,000 units
March (actual)	30,000 units	30,000 units
April	20,000 units	30,000 units
May	25,000 units	40,000 units
June	30,000 units	35,000 units
July	65,000 units	60,000 units
August	50,000 units	50,000 units

Cost of finished product should be average of beginning inventory of finished product with current month's production cost. It is expected that the selling price of $3 a unit can be maintained and that selling expense will retain a fixed relation to sales. Administrative expenses will remain unchanged during the period of your investigation.

Direct labor and material costs have a constant relation to production. Overhead expenses are at a minimum of $10,000 a month when production is at 10,000 units or less and increase with production at the rate of $1 for each $3 expended for direct labor. Such expenses consist: 50 per cent of indirect

labor and fixed monthly charges for insurance and taxes; 50 per cent comprises various manufacturing expenses exclusive of depreciation.

Insurance was taken out January 1 for three years at a cost of $3,600. Taxes of $12,000 per annum are payable June 20 and December 20 for current semi-annual periods.

It is desired that a raw material inventory be maintained sufficient only for the following month's requirements.

At a directors' meeting to be held during April a dividend of 10 per cent will be declared payable May 15.

Income taxes may be disregarded.

Problem 143

(New York, November, 1931)

The A. B. C. Motor Company has a branch factory in Long Island in which certain of the automobile parts are made. The factory was erected on leased land at a cost, including machinery, of $500,000. The funds for this were obtained on a serial debenture bond issue. Subsequently, additions to the plant were made with funds provided by a stock issue. A trial balance of the branch factory ledger at the end of last year showed:

Raw material purchases	$ 30,000	
Raw material transferred from stores		$ 40,000
Factory labor, direct	80,000	
Rent	8,000	
Bond interest (5% on $100,000)	5,000	
Real estate taxes	6,000	
Amortization of bond discount	5,000	
Insurance, fire	4,000	
Repairs	5,000	
Miscellaneous expenses	17,000	
Depreciation	20,000	
Raw material inventory, beginning of year	60,000	
In process inventory, beginning of year	30,000	
Transfers from raw material stores	40,000	
Transfers to main factory (1,000,000 units of finished goods)		200,000
Main factory		70,000
Totals	$310,000	$310,000

The operating results for last year are fairly typical of what may be expected in the future.

The reserve for depreciation at the end of the year on the branch plant and equipment amounted to $200,000. The annual depreciation charge of $20,000 is sufficient to wipe out the cost of the plant and the equipment within 20 years, the date of expiration of the lease. The annual charge of $5,000 for amortization of bond discount is sufficient to wipe out the deferred charge (which had a balance of $30,000 at the end of the year) by the date the bonds are to be paid off.

It has been proposed to the board of directors that the parts be purchased from a reliable parts manufacturer at a price, guaranteed by him for a long term, of 19 cents each. This manufacturer will also take over the lease and purchase of the plant for $175,000 and the inventory at 80 per cent of factory book value.

Prepare a schedule for the board of directors that will indicate to them whether at the end of the lease the company would be better off financially if it continued as at present or if it adopted the preceding proposal.

Problem 144

(Ohio, May, 1937)

On January 5, 1937, you were called in by The Portsmouth Manufacturing Company to prepare a balance-sheet as of December 31, 1936, and reconstruct an operating statement for the year 1936. Its financial records had been destroyed in a fire which occurred on January 1. You will also prepare such entries as the company will require in giving effect to the fire loss.

One of the officers had in his possession a memorandum of the December 31, 1936, inventory, according to the books, from which you obtained the following information:

Finished material (priced at cost of production)

Material		$ 80,000
Labor		60,000
Overhead:		
Indirect labor	$36,000	
Factory expense	7,200	
Depreciation	2,400	
Selling expense	10,800	
Administrative expense	3,600	60,000
Total		$200,000

From other officers and employees you obtained the following information:

There had been a constant increase in business throughout the company's history, each month's volume, beginning with initial shipments in February, 1936, being 10 per cent greater than shipments of the previous month. Shipments were invoiced, payable on tenth of the month following shipment, with 2 per cent discount uniformly allowed.

The company operated on a 20 per cent gross profit basis; *i.e.*, all sales were made at a price equal to cost of production plus 20 per cent.

Materials were purchased monthly at uniform prices, and production was completed in each month for the following month's shipments. Payments for materials were made, net, on tenth of month following purchase.

Labor at uniform rates was paid twice a month, on the fifth and twentieth for preceding sixteenth to thirty-first and first to fifteenth periods of each month, respectively.

Factory, selling and administrative expenses varied with production volume and were paid in the same month that such expenses were incurred. Local taxes and insurance were properly accrued and paid during the year. All such expenses were used in computing cost of production.

Depreciation for the year 1936 represented 4 per cent of the overhead entering into cost of production. One-half of this amount was computed on cost of machinery at 10 per cent per annum, and the remainder on the cost of buildings at 4 per cent. No additions to plant were made during the year. The cost of plant facilities on January 1, 1936, included $10,000 for land.

The corporate minute book in possession of the firm's attorneys showed that the company was incorporated and started business January 1, 1936, with paid-up capital stock of $500,000 par value. The directors had approved a declared value of $800,000 for the initial federal capital stock tax return filed in July covering the year ended June 30, 1936. The directors authorized the discounting at 6 per cent of the company's $200,000 ninety-day note on December 29 and the payment of a dividend on that date of $125,000. A list of salaried employees in the minute book showed aggregate compensation of $40,000 in the sales department and $18,000 in the general office for the year 1936.

Insurance was carried on inventory, machinery and buildings. The loss and insurance to be recovered are as follows:

	Loss	Insurance to be recovered
Buildings	10%	$30,000
Machinery	20%	20,000
Inventory	20%	30,000

Profit and loss account was charged with discounts, federal capital stock tax paid, depreciation and federal tax accruals. No provision had been made for social security tax which would apply to all employees.

Federal tax return forms (707 and 1120) are available for your guidance in computing proper tax accruals only. It is not desired that you prepare complete returns.

SECTION XVIII

CONSIGNMENTS, BRANCH AND RETAIL ACCOUNTING

Problem 145

(Ohio, May, 1935)

The Bright Light Corporation began business January 1, 1933, for the purpose of manufacturing and selling spotlights for automobiles. Sales in the western territory are made on a consignment basis through distributors who are billed at $7.20 per unit; and in the eastern territory, the company's salesmen sell direct to dealers, who are billed at $4 per unit.

The trial balance at December 31, 1934, was as follows:

	Debits		Credits
National bank deposit	$ 25,000	Reserve for bad debts	$ 10,000
Accounts receivable...	130,000	Reserve for depreciation:	
Inventories, January 1, 1934:		Machinery and equipment.	40,000
Raw materials......	20,000	Delivery equipment..	4,000
Finished goods at factory (25,000 lights).	70,000	Office equipment ..	2,000
Cash-surrender value life insurance ($100,000 policy), January 1, 1934	3,600	Notes payable to bank.	100,000
Machinery and equipment—life 10 years..	400,000	Accounts payable—trade	38,000
Delivery equipment—life 4 years	16,000	Accrued commissions...	12,000
Office equipment—life 10 years	20,000	Equipment bonds—5%	80,000
Deferred charges.....	3,900	Common stock........	300,000
Unamortized bond discount	15,000	Surplus	70,850
Raw materials purchased	130,000	Sales (200,000 lights)...	960,000
Factory labor.........	168,150	Other income.........	20,000
Indirect labor.........	16,500		
Factory rent..........	8,400		

	Debits		Credits
Freight and express outward	$ 35,000		
Light, heat and power	55,100		
Repairs—machinery and equipment	22,600		
Insurance	9,000		
Taxes	10,800		
Miscellaneous manufacturing expenses	90,400		
Salesmen's commissions	200,000		
Salesmen's traveling	20,000		
Advertising	15,000		
Delivery expenses	23,400		
Officers' salaries	74,000		
Office salaries	14,000		
Office supplies and expenses	10,000		
Bad debts	5,000		
Donations	2,000		
Discount on sales	20,000		
Bond interest	4,000		
Total	$1,636,850	Total	$1,636,850

In order to finance the purchase of equipment, on January 1, 1933, the company sold an issue of five-year 5 per cent serial equipment bonds at 85. The bonds mature annually in amounts of $20,000 beginning January 1, 1934. Interest is payable on December 31. No provision has been made on the books for amortization of bond discount; and upon your recommendation, the bond discount for the years 1933, 1934 and thereafter would be amortized by the bonds outstanding method.

On December 31, 1934, the company purchased a factory building for $250,000 and land for $50,000. To finance this purchase, a $300,000 issue of 6 per cent, cumulative preferred stock was sold to a syndicate. The common stock holders surrendered one-third of their stock as a bonus for the syndicate for handling the preferred stock transaction. The proceeds from the sale of the stock had been received from the syndicate, and the payment made for the land and building, but the transactions had not been entered on the books.

During the year, 225,000 spotlights were produced; 150,000 were shipped to dealers and 50,000 were shipped to consignees. There were 50,000 finished spotlights on hand at the factory at

December 31, 1934. Finished goods inventory was valued at current year's cost of manufacturing. Raw material inventory, December 31, 1934, was valued at $24,000, being the lower of cost or market.

Commissions were credited to salesmen and consignees at $1 per unit, when sold. Reports from consignees showed 10,000 spotlights in their hands unsold and 2,000 lights sold but proceeds not remitted at December 31, 1934.

An analysis of accounts receivable at the end of the year was as follows:

Customers' accounts—dealers	$ 37,000
Consignments:	
Unsold spotlights 10,000 @ $7.20	72,000
Spotlights sold, but consignees have not remitted 2,000 at $7.20 each	14,400
Officers and employees	6,600
Total	$130,000

The notes payable to banks were secured by $100,000 life insurance policy carried by the company on the life of the president. Communication with the insurance company indicated that the cash surrender value at December 31, 1934, was $4,500.

No depreciation had been entered for 1934. Your analysis of expense accounts for the year revealed the following information:

Officers' salaries for the month of June 1934, charged to factory labor	$6,000
Factory payroll paid January 2, 1935, was charged to labor in 1935 but covered the payroll for the week ended December 31, 1934	3,450
Life insurance premium charged to insurance	1,000
State franchise tax charged to taxes	800
Delivery truck repairs charged to machinery and equipment repairs	2,600

The accrued federal income tax for the year 1934 had not been entered—income-tax rate 13¾ per cent.

Required:

1. Balance-sheet at December 31, 1934.
2. Statement of profit and loss, year ended December 31, 1934.
3. Statement of gross profit, year ended December 31, 1934, showing separately gross profit on dealer sales and on

consignment sales after deducting commissions. (Do not attempt to distribute other selling, administrative and delivery expenses.)

Problem 146

(American Institute of Accountants, November, 1931)

The trial balance (condensed) of Company A, as at December 31, 1930, was as follows:

	Dr.	Cr.
Cash	$ 2,438	
Accounts receivable	37,097	
Inventories—January 1, 1930:		
Raw material	7,492	
Jobbing goods	2,564	
Finished goods	10,473	
Machinery and equipment	14,622	
Prepaid insurance	1,300	
Purchases:		
Raw material	88,838	
Jobbing goods	44,045	
Sales:		
Manufactured goods—net		$163,721
Jobbing goods		54,601
Sundry accounts, apart from those detailed, applicable to cost of manufacturing and cost of sales	43,232	
Sundry expense accounts, applicable to profit and loss	51,312	
Notes and accounts payable		24,215
Reserves:		
For depreciation		12,021
For doubtful accounts		3,500
To reduce "Company B's" account to inventory cost value—January 1, 1930		144
Capital stock		18,500
Surplus		26,711
Totals	$303,413	$303,413

Included in the accounts receivable of Company A is an account with "Company B," which is in reality a title only, used by A in selling merchandise on consignment to certain small dealers.

An analysis of this account, as it appears in the accounts-receivable ledger of Company A, is as follows:

	Dr.	Cr.
Balance—January 1, 1930	$3,600	
Shipments during 1930	632	
Selling expenses	58	
Cash collections during 1930		$2,34
Credit memos. issued in 1930 for goods returned		2,56
Totals	$4,290	$4,90
Total debits		4,29
Credit balance		$ 61

All cash collected from the customers of "B" is credited to thi company's account on the books of A. This procedure has bee in vogue for several years.

A list of balances of customers' consignment accounts of "B' totals $1,218 (which is accepted as correct), representing th prices at which the garments are sold to the public by the cus tomers of "B." These customers remit only for garment actually sold and deduct 20 per cent for their profit. A garmen billed to "B" by Company A at the latter's regular selling pric of $2 is then sold to the public by the customers of "B" for $2.90 The same proportion holds throughout. Shipments, inventorie and sales consist of 75 per cent of manufactured goods and 25 per cent of jobbing goods.

On the articles handled by "B," Company A earns a gros profit of 35 per cent on its selling price on manufactured good and 25 per cent on jobbing goods.

A physical inventory of goods on hand at the plant of Company A, at the close of business, December 31, 1930, was as follows:

Raw material	$6,780
Jobbing goods	4,463
Finished goods	7,246

From the foregoing trial balance and following data, prepare

(1) Journal entries necessary to adjust the account of "Company B";
(2) Statement of cost of goods manufactured and cost of sales;
(3) Statement of profit and loss for the year ended Decembe 31, 1930;
(4) Balance-sheet as at the close of business, December 31, 1930.

Problem 147

(New York, May, 1931)

The U. P. U. Steamship Company established a passenger and freight service between its home South American ports and New York. Some ships are owned; others are chartered as required. The line has an agency in New York. The agent is required to furnish monthly reports, a yearly account current and a yearly statement of cash receipts and disbursements. At the end of the year 1930, the agency general ledger trial balance is as follows:

Trial balance—general ledger, December 31, 1930

Advances to skippers—chartered ships	$ 2,494.46	
Agency equipment	16,709.94	
Agency rent	10,104.00	
Agency salaries	55,682.00	
Allowances on in freight	25,311.02	
Allowances on out freight	4,391.62	
Brokerage and insurance—out freight	15,362.52	
Cartage	3,014.18	
Cash in bank	114,657.56	
Cash in offices	342.48	
Certificates of deposit	10,000 00	
Claims for shortages paid	5,535 70	
Consular fees	3,587.46	
Consulting engineers' fees	5,540.00	
Dock equipment	17,714.76	
Dock rent	60,000.00	
Dock supplies and expenses	12,831.78	
Due for coal purchased for home office		$ 122,700.00
Due for equipment purchased for home office		66,000.00
Dunnage	9,090.76	
Electric light and power—docks	58,305.18	
Excess baggage—passenger service		2,381.30
Fuel	495,530.82	
Funeral expenses of sailors—ships of line	6,076.08	
Head tax—passenger service	4,344.00	
Hire of chartered ships	1,336,375.94	
Hire of chartered ships—contested		20,800.00
Home office account	3,458,375.84	
In-freight earnings		3,819,005.12
In-freight receivable	116,957.80	
Inspection and fumigating	11,965.72	
Insurance claims receivable	6,000.00	

Interest on bank balances		$ 3,841.18
Interest on loans	$ 3,000.00	
Lighterage	6,651.50	
Miscellaneous expense—agency	13,992.96	
Miscellaneous fees		130.84
Oil and engine room supplies	29,284.36	
Out-freight earnings		3,027,235.88
Out-freight receivable	4,371.40	
Passenger traffic earnings		93,135.84
Payroll—officers and crews	169,296.02	
Pilotage, towing, etc	25,480.42	
Receivable—United States mail	10,000.00	
Rental of wharf		10,942.74
Repairs—ships of line	533,103.60	
Revenue stamps used	4,600.00	
Salaries and wages—dock office	44,365.62	
Ship chandlery	176,701.76	
Stevedoring and derricking	121,098.76	
Telegrams and cables—general	30,400.64	
Transportation of United States mail		14,966.58
Victualing	133,149.76	
Water for ships	3,254 82	
Workmen's compensation—docks	6,086.24	
Totals	$7,181,139.48	$7,181,139 48

Analysis of home office account

Debits

Remittances to home office		$ 376,808.12
Purchase of equipment per home office order shipped		205,636.90
Purchases of coal for home office		2,771,665.74
Out freight on shipments to home office, credited to earnings—goods shipped by ships of line		216,835.76
Sundry purchases and payments per home office books		18,548.10
Overdraft, January 1, 1930		7,394.78
Total debits		$3,596,889.40
Credits		
Receivable for in freight	$ 26,370.50	
Receivable for out freight	28,250.64	
Agency equipment	16,148.22	
Dock equipment	10,808.94	
Insurance claims receivable	14,789.56	
Cash advances by home office	42,145 70	138,513.56
Debit balance		$3,458,375.84

During 1930, $100,000 was borrowed on six months' notes; these were repaid.

Requirements:

1. Agency account current for the year.
2. Statement of cash receipts and disbursements.

Problem 148

(New York, October, 1936)

The Lauder Manufacturing Company was organized as of January 1, 1935, with a capital stock issued and outstanding of $700,000.

From the following trial balance taken from the company's books at the end of the first year's business, prepare:

1. Statement prepared by company showing how the $323,600 net profit (see page 302) was computed.
2. Statements as they should be prepared for the company:
   a. Balance-sheet, December 31, 1935.
   b. Profit and loss statement, year ended December 31, 1935.
   c. Statement conservatively drawn, showing cost of manufacture and cost of manufactured product sold.

THE LAUDER MANUFACTURING COMPANY
Trial balance, December 31, 1935

	Debits	Credits
Cash	$ 78,400	
Accounts receivable	76,000	
Plant and equipment	600,000	
Reserve for depreciation		$ 30,000
Notes payable		160,000
Accounts payable		90,000
Capital stock		700,000
Branch accounts	199,200	
Sales to customers and branch—144,200 units @ $8 each		1,153,600
Raw materials purchased	750,000	
Productive labor	150,000	
Nonproductive labor	60,000	
Manufacturing expenses	60,000	
Selling expenses	100,000	
Administrative and general expenses	50,000	
Purchase discounts		10,000
Sales discounts	5,000	
Interest expense	15,000	
Totals	$2,143,600	$2,143,600

The inventories at the close of the first year, as per books, were:

Raw materials	$150,000
Work in process	160,000
Finished goods	100,000

A dividend was declared on December 28, 1935, of 6 per cent on the capital stock, payable January 2, 1936.

The profit and loss statement for the year, as submitted to creditors, showed a net profit of $323,600.

The general books do not control the cost records.

The market value of the raw material on hand was $125,000. For the inventory the valuation was at cost.

Overhead included in the cost of production for the year consists of:

Indirect labor	$60,000
Manufacturing expenses	60,000
Interest on investment	60,000

Work in process, as per company cost sheets, is valued as follows:

Material	$36,000
Productive labor	62,000
Overhead	62,000

On the last day of the year there were 36,050 units finished on hand, valued per cost sheets at $100,000.

The branch office reports the following:

Cash	$ 4,000	
Accounts receivable	51,000	
Purchases from home office—108,150 units at $8	865,200	
Sales—90,125 units		$721,000
Home office control		199,200
Totals	$920,200	$920,200

At December 31, 1935, 18,025 units were on hand at branch office.

Problem 149

(New York, November, 1931)

The Okeh Corporation began business in the early part of 1929, selling goods both for cash and under the instalment plan. It

has been agreed that the accounts of the company shall be kept so that the instalment income may be determined in harmony with the provisions of the Revenue Act of 1928.

As of January 1, 1930, the company's ledger shows the following balances which relate to the business of 1929:

	Debits	Credits
Cash	$ 614,508.10	
Instalment sales contracts, 1929	1,113,666.56	
Inventory	309,353.68	
Accounts payable		$1,412,404.28
Unrealized gross profit on instalment sales contracts, 1929		649,638 83
Profit and loss	24,514.77	
Totals	$2,062,043.11	$2,062,043.11

An analysis of the transactions for the year 1929 follows:

Purchases	$1,301,484.48
Purchase returns	75,562.44
Cash sales	271,974.64
Cash sales returned	28,688.72
Instalment sales	1,484,888.74
Inventory, December 31, 1929	309,353.68
Expenses	186,482.24
Cash collections on instalment accounts	371,222.18
Instalment goods were to be marked up to yield 50% gross profit based on sales.	
Expenses were to be allocable 91% to instalment sales, 9% to cash sales.	

For some reason, the books were not written up for 1930, although complete documentary evidence is available for such purposes. In summary form, this evidence shows the following:

Purchases	$ 890,789.44
Purchase returns	33,685.90
Cash sales	258,944.88
Cash sales returned	20,753.84
Instalment sales	1,686,453.82
Inventory, December 31, 1930	84,744.42
Repossessions of 1929 instalment sales (valued at)	20,000.00
Expenses	335,996.74
Cash collections on instalment accounts:	
1929	648,933.24
1930	421,613.46

Instalment goods were to be marked up to yield 45 % gross profit based on sales.	
Expenses were to be allocable 88 % to instalment sales, 12 % to cash sales.	
Repossessed goods were originally sold for (see above)	$ 50,000.00
Cash collections on repossessed goods (included in collections above):	
During 1929	12,000.00
1930	12,000.00

Submit correct postclosing trial balance of ledger, December 31, 1930. (Ignore tax determination.)

Problem 150

(Ohio, May, 1934)

The Water Softener Sales and Service Company was incorporated January 1, 1932, under the laws of the State of Ohio, for the purpose of distributing and servicing water softeners. Terms of sale: net, 30 days; repair service, cash. The authorized capital stock, all of which was issued, consisted of 1,000 shares 6 per cent cumulative preferred and 5,000 shares common, the shares in each case having a par value of $100.

You were retained by the board of directors to make an audit of the books of the company for the two years ended December 31, 1933. The following postclosing trial balance, as of that date, was furnished by the chief accounting officer:

	Debits		Credits
Cash	$ 75,000	Capital stock	$ 600,000
Notes receivable	15,000	Surplus	305,100
Accounts receivable	412,500	Bonds payable	100,000
Inventories, December 31, 1933	312,000	Notes payable	220,500
Prepaid expenses	1,000	Accounts payable	39,750
Bond discount	4,265	Accrued taxes	5,250
Land	30,600	Accrued payroll	4,500
Building	170,000	Reserve for bad debts	14,265
Service shop equipment	120,000	Notes receivable discounted	5,000
Delivery equipment	16,000		
Office equipment	8,000		
Stock in A Company	130,000		
Total	$1,294,365	Total	$1,294,365

The profit and loss account for the years ended December 31, 1932 and 1933, was shown by the books as follows:

	1932	1933
Total water softeners sold	20,000	25,375
Net sales	$1,000,000	$1,522,500
Gross profit on service sales	1,000	500
Other income	1,000	500
Totals	$1,002,000	$1,523,500
Cost of goods sold	$ 659,750	$ 878,250
Selling expenses	121,000	296,000
Shop expenses	39,500	39,700
Administrative and general expenses	49,200	100,000
Miscellaneous expenses	12,000	15,000
Bond interest	5,000	5,000
Totals	$ 886,450	$1,333,950
Net profit	$ 115,550	$ 189,550

At December 31, 1933, the cash consisted of the following:

National Bank and Trust Company	$35,000
City Bank and Trust Company (Overdraft)	*10,000*
State bank—bond sinking fund	40,000
Customers' postdated checks in payment of 1933 accounts	5,000
Customers' dishonored checks in payment of 1933 accounts	2,000
Petty cash	3,000
Total	$75,000

On January 1, 1932, the company sold an entire issue of first-mortgage, five-year, 5 per cent bonds amounting to $100,000 for $95,735, to net 6 per cent; interest payable June 30 and December 31. The bond discount is to be amortized by the scientific method. The agreement provided for annual contributions to a sinking fund of $20,000, without interest, and the creation of a sinking-fund reserve.

An analysis of the accounts receivable at January 1, 1933, and December 31, 1933, showed the following:

	January 1, 1933	December 31, 1933
Customers' regular accounts (1932 sales)	$200,000	$ 90,000
Customers' regular accounts (1933 sales)		200,000
Type A softener sales on consignment basis billed at the average unit selling price of all types, which was 125 % of the unit cost of type A softeners—shipped December 28, 1933		22,500

	January 1, 1933	December 31, 1933
Customers' accounts (1933 sales) assigned to The Finance Company, terms: cash $70,000, discount fee $5,000 to be charged to expense, balance deferred. The check from The Finance Company was received December 30, 1933, but not entered		$100,000
Totals	$200,000	$412,500

The inventories at December 31, 1932, were valued at the lower of cost or market, and in checking the prices you found them understated $9,750. The inventories at December 31, 1933, were taken and priced under your supervision. They were summarized as follows:

	Cost	Market
Type A softeners	$ 20,000	$ 30,000
Type B softeners	100,000	70,000
Type C softeners	162,000	200,000
Type D softeners	30,000	40,000
Totals	$312,000	$340,000

On January 1, 1933, the company purchased 1,000 of the 1,500 shares in the A Company at book value; par $100 per share. The A Company reported a loss of $30,000 for the year ended December 31, 1933. The directors of A Company declared a 6 per cent dividend to stockholders of record, December 15, 1933, payable January 15, 1934. No financial statement was available, and the management requested that the A Company stock be shown on the Water Softener Company balance-sheet at book value.

The Water Softener Company purchased the plant and equipment from a former competitor on January 1, 1932. No additions had been made to the property since that date, and no provision had been made on the books for depreciation. On January 1, 1933, an appraisal was made by a reputable concern, and the directors authorized you to enter on the books the appraised values as summarized below:

	Reproduction new	Sound value
Land	$ 35,600	$ 35,600
Building	250,000	210,000
Service shop equipment	175,000	150,000
Delivery equipment	16,000	12,000
Office equipment	10,000	9,000

Disregard depreciation on appreciation. Compute depreciation in conformity with the federal income-tax law at the following rates: building, 5 per cent; service-shop equipment, 10 per cent; delivery equipment, 25 per cent; office equipment, 10 per cent.

The management desires to know the reasons for the change in the net profit for the year ended December 31, 1933, from the net profit for the year ended December 31, 1932. Your opinion was also asked as to what the net profit for the year ended December 31, 1933, would have been if the sale of softeners for 1932 and 1933 had been on the instalment contract basis and if the accounts receivable had not been assigned to The Finance Company.

Required:

1. Balance-sheet as of December 31, 1933.
2. Comparative statement of profit and loss, years ended December 31, 1932 and 1933.
3. Statement of variation in net profit.
4. Statement of profit and loss on the instalment sales basis, year ended December 31, 1933.
5. Work sheet.

Submit requirements (1) and (2) in ink. Disregard computation of income tax.

Problem 151

(District of Columbia, May, 1931)

Woods and Bray, a partnership, specialize in the complete furnishing of homes and apartments on the instalment plan, whereby an initial deposit of 15% is required, the balance being payable over a period of four years. A discount of 2% on instalment sales prices is allowed on all cash and ordinary credit sales.

Following is a trial balance of Woods and Bray at December 31, 1930:

Woods and Bray
(A partnership)
Trial balance, December 31, 1930

Particulars	Debits	Credits
Cash in bank	$ 5,188.50	
Instalment accounts receivable	223,066.00	
Ordinary accounts receivable	4,954.00	

Particulars	Debits	Credits
Reserve for bad debts:		
Instalment		$ 3,000.00
Ordinary		400.00
Inventory of furniture, valued at the lower of cost or market, January 1, 1930	$101,767.00	
Reserve withheld by Furniture Finance Trust	11,733.25	
Unexpired insurance, December 31, 1930	665.00	
Store fixtures	4,900.00	
Reserve for depreciation—store fixtures		1,864.00
Delivery truck	996.00	
Reserve for depreciation—truck		124.50
Electric sign	2,525.00	
Reserve for depreciation—sign		2,072.60
Bank loan		9,000.00
Accounts payable		11,891.03
Due to Furniture Finance Trust		76,755.00
Harry B. Woods, capital		155,491.75
William R. Bray, capital		51,260.87
Harry B. Woods, drawing	2,580.00	
William R. Bray, drawing	1,230.00	
Totals	$359,604.75	$311,859.75
Net profit		47,745.00
Totals	$359,604.75	$359,604.75

WOODS AND BRAY
(A partnership)
Trial balance, December 31, 1930

	Debits	Credits
Sales:		
Cash sales		$ 16,156.00
Ordinary credit sales		48,244.00
Instalment sales		182,950.00
Purchases:		
New	$135,807.00	
Depreciated cost of furniture repossessed	3,500.00	
Repairs on repossessed furniture	712.00	
Partner's salary	5,200.00	
Interest paid	682.00	
Furniture Finance Trust—interest charges	12,567.00	
Bad debts:		
Instalment accounts	2,555.00	
Other accounts	385.00	
Loss on repossessions	3,674.00	
Other salaries, rent, advertising, taxes, etc	34,523.00	
Totals	$199,605.00	$247,350.00
Net profit	47,745.00	
Totals	$247,350.00	$247,350.00

Changes in instalment accounts receivable during 1930 are summarized below:

Year of sale	Unpaid balance January 1, 1930	Increase: Sales	Decrease: Collections	Decrease: Reposses-sions	Decrease: Bad debts	Decrease: Total	Unpaid balance December 31, 1930
1925	$ 3,802.00		$ 1.760.00		$ 770.00	$ 2,530.00	$ 1,272.00
1926	3,244.00		1,191.00	$ 590 00	465.00	2,246.00	998.00
1927	19,222.00		11,909.00	670.00	820.00	13,399.00	5,823.00
1928	38,947.00		18,626.00	1,051.00	325.00	20,002.00	18,945.00
1929	87,464.00		25,355.00	2,695.00	175.00	28,225.00	59,239.00
1930		$182,950.00	43,993.00	2,168.00		46.161.00	136,789.00
Totals	$152,679.00	$182,950.00	$102,834.00	$7,174.00	$2,555.00	$112,563.00	$223,066.00

Additional data on repossessions:

Year of sale	Sale price of furniture repossessed	Cash forfeited	Unpaid balance	Value of furniture repossessed, estimated on basis of cost less depreciation
1926	$ 1,200.00	$ 610.00	$ 590.00	$ 250.00
1927	1,550.00	880.00	670.00	300 00
1928	2,550.00	1,499.00	1,051.00	650 00
1929	4,100.00	1,405.00	2,695.00	1,300.00
1930	2,800.00	632 00	2,168.00	1,000.00
Totals	$12,200.00	$5,026.00	$7,174 00	$3,500.00

The foregoing repossessions were recorded as follows:

Depreciated cost of furniture repossessed	$3,500.00	
Loss of repossessions	3,674.00	
Instalment accounts receivable		$7,174.00

The unrealized profit at December 31, 1929, as determined from the partnership income-tax returns, which were filed on the instalment basis, follows:

Year of sale	Instalment accounts receivable	Unrealized gross profit Per cent	Amount
1925	$ 3,802 00	53	$ 2,015 06
1926	3,244.00	49	1,589.56
1927	19,222.00	51	9,803.22
1928	38,947.00	50	19,473.50
1929	87,464 00	54	47,230.56
Totals	$152,679 00		$80,111.90

Bad debt losses were charged directly to expense. The reserves for bad debts appearing on the books are considered adequate.

At December 31, 1930, an analysis of the receivables and the loan from the finance company revealed the following:

Particulars	Past due	Due in 1931	Due after 1931	Total
Instalment accounts receivable	$12,300.00	$73,500.00	$137,266.00	$223,066.00
Ordinary receivables	506.00	4,448.00		4,954.00
Loan from finance company		31,250.00	45,505.00	76,755.00

The opening inventory was overstated $3,600 through an error in footing the summary. This error resulted in overstating the

1929 gross profit percentage on instalment sales by 2 per cent. The gross profit reported in 1929 on collection on 1929 instalment sales totaled $16,200.

The closing inventory, valued at cost, was $101,192; and at the lower of cost or market, $99,362.50.

The schedule prepared on loans from the finance company shows prepaid interest of $4,623.

Provide depreciation for 1930, using the rates prevailing in past years, as follows:

	Per cent
Store fixtures	10
Delivery equipment	25
Electric sign	20

Instalment accounts receivable were financed in part during 1930 by loans from the Furniture Finance Trust on assigned accounts. The interest charge is 20 per cent on four-year accounts, with a decreasing charge on shorter term receivables. In addition the finance company retains a 15 per cent deposit refundable as the loan is liquidated. Payments on loans are based on the instalments maturing each month on receivables assigned.

The 6 per cent bank loan of $9,000 matures January 2, 1931, interest thereon having been prepaid.

Since the formation of the partnership in 1920, profits have been divided as follows:

Harry B. Woods	⅔
William R. Bray	⅓

On January 1, 1930, William R. Bray discontinued active participation in the management and operation of the partnership. To compensate Harry B. Woods for his services, the following clauses were added to the partnership agreement:

"1. Each partner shall be allowed interest at the rate of 5 per cent on the balance in his capital account at the beginning of each year, excluding unrealized profit.

"2. Harry B. Woods shall be allowed a salary of $5,200 per annum, payable $100 per week.

"3. Harry B. Woods shall be entitled to a bonus of 5 per cent of net profits computed on the accrual basis, after interest on capital accounts but before bonus."

From the foregoing prepare:

1. Journal entries necessary to adjust the books and to place them on the instalment basis.
2. Balance-sheet at December 31, 1930, on the instalment basis, supported by a schedule of changes in the partners' capital accounts.
3. Statement of profit and loss for the year 1930 to show the net profit, both on the accrual basis and on the instalment basis.
4. Auditor's certificate to be attached to the balance-sheet.

Problem 152

(Ohio, November, 1934)

The Excello Electric Washer Company began manufacturing electric washing machines on January 2, 1932. Sales are made to dealers on the instalment basis. You were retained by the board of directors to audit the books for the two years ended December 31, 1933.

Postclosing trial balance, December 31, 1933

	Debits		Credits
Accounts receivable	$ 312,000	Accounts payable	$ 118,000
Bank account	77,400	Accrued payroll	10,000
Cash	1,600	Bonds payable—first mortgage 6%	200,000
Cash in closed state bank	10,000	Capital stock:	
Deferred charges	13,000	Preferred—8,500 shares—7% cumulative	850,000
Factory building—50-year life	500,000	Common—900 shares—no par	900,000
Inventories, December 31, 1933	1,128,292	Notes payable to bank	100,000
Land	60,000	Reserve for bad debts	30,000
Machinery and equipment—20-year life	240,000	Reserve for inventory adjustment	13,042
Municipal bonds—4½% cost and par	26,500	Surplus	141,750
Notes receivable—customers	15,000	Unrealized profit, January 1, 1933	132,000
Office equipment—10-year life	20,000		
Prepaid expenses	20,000		
Stocks in other companies—cost	50,000		
Salesmen's cars—4-year life	16,000		
Unamortized bond discount	5,000		
Total	**$2,494,792**	**Total**	**$2,494,792**

Profit and loss account at December 31, 1933

	Debits		Credits
Cost of goods sold	$1,046,000	Sales	$1,412,000
Selling expenses	175,000	Profit on preferred stock retired	37,500
Administrative expenses	155,000	Other income	17,000
Other expenses, including bond interest	30,000		
Transferred to surplus	60,500		
Total	$1,466,500	Total	$1,466,500

The raw material, the work in process and the finished goods accounts in the factory ledger were analyzed as follows:

	Debits		Credits
Raw material:			
Inventory, January 1, 1933	$ 180,000	Transferred to work in process	$ 730,000
Purchases	890,000	Balance	340,000
	$1,070,000		$1,070,000
Work in process:			
Inventory, January 1, 1933	$ 20,250	Transferred to finished goods	$1,196,660
From raw material	730,000	Balance	30,132
From labor	310,000		
From factory overhead	166,542		
	$1,226,792		$1,226,792
Finished goods:			
Inventory, January 1, 1933	$ 607,500	Transferred to cost of goods sold	$1,046,000
From work in process	1,196,660	Balance	758,160
	$1,804,160		$1,804,160

The minutes of the board of directors meeting January 2, 1932, provided for the creation of a sinking fund and a sinking-fund reserve out of profits for the purpose of renewing the entire investment of $240,000 in machinery and equipment purchased on that date. The estimated life of the equipment is 20 years. The contributions to the sinking fund, which will be invested at 4½ per cent, are to be made at the beginning of each year, and interest will be received at the end of each year. The officers have failed to act and have asked you to set aside from the investment in municipal bonds, which are in denominations of

$100 and $1,000, and from cash enough for the two years' contributions to the sinking fund, including interest. An annuity table shows that the amount of an ordinary annuity of $1 for twenty years at 4½ per cent is 31.3714227.

In 1933, the company purchased and retired 1,500 shares of its preferred stock at $75 per share; the difference of $25 per share was credited to profit and loss account.

The confirmation received from the bank showed customers' notes discounted in the amount of $10,000 at December 31, 1933. The bank also reported a balance of $206,000 in excess of the reconciled book balance. It was found that this amount represented the net proceeds from an issue of $225,000 first-mortgage 4 per cent bonds, dated December 31, 1933, and maturing January 1, 1944, sold for the purpose of calling the first-mortgage 6 per cent bonds at 103. The called bonds were in, for which checks had been issued but not recorded. The interest and amortization on the 6's had been paid and entered.

In checking the December 31, 1932, inventories, you found errors that increased raw materials $20,000; work in process $2,750; and finished goods $6,500.

The cost system being new, the management believed the monthly financial statements should be safeguarded against overstatement of profits; consequently monthly journal entries were ordered made, [illegible] factory overhead and crediting a reserve for inventory adjustment; the total of these entries for the year 1933 was $13,042.

The receiving records showed that a shipment of raw material had been received December 30, 1933. The invoice for these goods amounting to $10,000 had been approved on the same date but was not entered or inventoried.

No provision had been made on the books for depreciation for 1932 and 1933. You also found county taxes of $7,500 chargeable to factory overhead for the last half of 1933 not entered. The factory payroll payment for the last week of 1933, amounting to $10,000, was charged to labor instead of accrued payroll. No action on dividends was taken by the directors during the two years.

An analysis of the accounts receivable of $312,000 was as follows:

Balance, January 1, 1933		$ 600,000
Instalment sales, 1933		1,412,000
Total		$2,012,000
Received on account—1932 charges	$ 500,000	
Received on account—1933 charges	1,200,000	
Total		1,700,000
Balance		$ 312,000

Your adjustments for 1932 and an error on the part of the chief accounting officer changed the gross profit on net sales for that year from 22 per cent to 20 per cent. The reserve for bad debts you found to be adequate.

The cost records for 1933, after adjustment, showed the correct closing inventory of raw material; the work in process at the end of 1933 amounted to $21,000, and the finished goods $790,000.

Required:

1. Balance-sheet as of December 31, 1933.
2. Statement of profit and loss on the instalment sales basis, year ended December 31, 1933.
3. Correct cost accounts for raw material, work in process and finished goods for 1933.
4. Work sheet.

Submit requirements 1 and 2 in ink. Disregard income tax.

Problem 153

(Ohio, October, 1930)

The General Outfitting Company engaged in the retail furniture business on January 1, 1925, and took a lease of the property that it was to occupy for a period of ten years from that date. Alterations were necessary, and the actual amount expended therefor before occupancy appears in trial balance. The records were kept on what is known as the instalment sales method, and its federal income-tax returns were filed accordingly.

On March 1, 1930, you had completed your audit of the records; and trial balance taken on December 31, 1929, showed the following:

Debits	
Cash on hand	$ 500
Cash in bank	75
Notes receivable	1,500
Accounts receivable—customers	
1925 accounts	5,000
1926 accounts	15,000
1927 accounts	45,000
1928 accounts	135,000
1929 accounts	200,000
Merchandise—inventory, January 1, 1929	80,000
Merchandise purchases	200,000
Alterations to leased property	10,000
Furniture and fixtures	5,000
Delivery equipment	2,500
Securities owned	
U. S. bonds	22,000
U. S. Steel Company stock	10,000
Salaries—office and officers	45,000
Office expenses	7,500
Travel expenses	500
Taxes—county and state	13,000
Taxes—federal income	4,000
Advertising	62,000
Sales salary and commissions	45,000
Dividends paid	10,000
Incoming freight	5,750
Insurance—fire, etc	1,800
Insurance—life	1,500
Interest on items payable	750
Rent	15,000
Light, heat and power	5,000
Bad accounts	5,000
Repairs	1,200
Donations	500

Credits	
Notes payable	$ 15,000
Accounts payable	37,000
Reserve for unrealized profits	
1925 accounts	6,900
1926 accounts	21,150
1927 accounts	64,800
1928 accounts	98,000
Reserve for depreciation—autos 25%	2,500
Reserve for depreciation—fixtures 10%	2,000
Capital stock	200,000
Sales	415,750
Discounts earned	4,000
Interest on notes receivable	45
Forfeitures	25,000
Bad accounts recovered	1,500
Interest on U. S. bonds	990
Dividends received	600
Surplus	59,840

All goods repossessed were appraised at a value that would produce about the same gross profit as new merchandise and were charged to merchandise purchases, credit having been passed to accounts receivable; and in all cases the accounts receivable affected reflected credit balances which were trans-

ferred to forfeiture account which you are to consider as an extraneous profit.

The merchandise inventory on December 31, 1929, amounted to $77,875 including freight and unsold repossessed goods at appraised value.

No adjustment of the reserve for unrealized profits had been made as at December 31, 1929, and an analysis of accounts receivable on December 31, 1928, follows.

1925 accounts	$ 15,000
1926 accounts	45,000
1927 accounts	135,000
1928 accounts	200,000

In addition to the foregoing information, the following items were not provided for:

Accrued office salaries	$ 500
Accrued sales expense	750
Accrued taxes (county)	13,000
Accrued advertising	2,000
Accrued interest on items payable	150
Unexpired insurance	300
Interest accrued on notes receivable	45

For purposes of this problem, assume that the company's taxable income was in excess of $30,000 annually for years 1925 to 1928 inclusive and that the tax rate averaged 12½ per cent throughout the same period. The rate for 1929 was 11 per cent.

You are requested to make all adjustments necessary and prepare:

1. Balance-sheet as at December 31, 1929.
2. Profit and loss statement for year 1929 on accrual basis.
3. Statement of net taxable income for year 1929 for federal income-tax purposes.

Problem 154

(Ohio, May, 1931)

The Retail Store Company uses the retail inventory method, controlling its merchandise inventory by use of retail values. It

keeps a record of markup and markdown, this being the differential between cost and the retail prices marked on its merchandise. This record for 1930 contains the following information:

	A Cost	Department Retail	Cost	B Retail
Inventory, January 1, 1930	$225,000	$300,000	$ 90,000	$135,000
Purchases	688,900	900,000	399,900	550,000
Additional 1930 markups		35,000		25,000
Markdowns, 1930		15,000		10,000

You find that real estate taxes were charged to expense as paid, whereas the proper accrued liability at January 1, 1930, was $1,800 and at December 31, 1930, amounted to $2,400. Fire insurance prepaid at January 1 was $1,600 and at December 31 was $3,700.

On December 31, 1930, the following transactions were consummated but not recorded:

1. The Realty Company was organized and issued its shares, consisting of 300 without par value, to The Retail Store Company in payment for its land and building.
2. The Realty Company leased the premises to the Retail Store for 50 years for a flat annual rental of $25,000, the Realty Company agreeing to pay taxes payable after execution of the lease.
3. The Realty Company sold an issue of $325,000 first-mortgage, 5 per cent, 50-year bonds, realizing $295,000, of which $160,000 was held by the trustee for improvements to the store building and the remainder was loaned to The Retail Store for working capital.
4. The Retail Store Company sold an issue of $50,000 first-mortgage, 6 per cent, 10-year, leasehold bonds at 90 and with the cash funds then at its disposal pays off all its outstanding notes.

From the foregoing and the accompanying trial balance, prepare journal entries, an income and expense statement for the year 1930 and consolidated balance-sheet at the close of business on December 31, 1930.

The Retail Store Company
Trial balance, December 31, 1930

Accounts payable		$ 147,000
Accounts receivable	$ 190,000	
Advertising	28,200	
Capital stock		550,000
Cash	18,000	
Delivery equipment	18,000	
Depreciation—buildings	5,000	
Depreciation—fixtures	4,700	
Depreciation—delivery equipment	3,600	
Delivery expense	17,900	
Discounts earned		24,000
Dividends earned		2,000
Donations	600	
Fixtures	47,000	
Insurance (fire and liability) premiums paid	5,200	
Interest on government bonds		200
Inventory, January 1, 1930	315,000	
Land	50,000	
Notes payable		185,000
Officers' term life insurance	1,600	
Purchases	1,088,800	
Reserve for depreciation—building		25,000
Reserve for depreciation—fixtures, etc		23,000
Sales—Department A		840,000
Sales—Department B		362,500
Sales returned—Department A	70,000	
Sales returned—Department B	22,500	
Salaries and wages	127,000	
Store building	250,000	
Stocks (listed)	20,000	
Supplies, expenses, etc.	49,300	
Surplus, January 1, 1930		189,500
Taxes—income 1929	12,000	
Taxes—real estate	3,800	
Totals	$2,348,200	$2,348,200

Problem 155

(New York, June, 1932)

The books of the Acme Company, a store with four departments, show information covering a two-month period, as follows:

Opening inventories at sales prices and percentage of markup:

Department		
1	$90,630	100%
2	42,780	50%
3	36,000	33⅓%
4	28,000	25%

Purchases during the two-month period:

Department	Cost	Selling
1	$98,950	$172,000
2	45,000	75,000
3	40,000	66,200
4	42,000	58,100

Sales and markdowns during the two-month period:

Department	Sales	Markdowns
1	$172,500	$11,500
2	67,500	9,000
3	71,250	7,300
4	63,750	5,600

Direct expenses chargeable to departments:

	Department 1	Department 2	Department 3	Department 4
Salaries	$18,000	$8,500	$7,400	$3,100
Advertising	4,500	3,900	2,800	2,300
Rent	9,000	3,800	1,800	1,400

Indirect expense distributable to departments, $42,000.
Basis of distribution to be sales.
Required:

1. Departmental statements of earnings and expenses.
2. Statement showing departmental turnover.

Problem 156

(District of Columbia, May, 1936)

From the following information prepare the necessary adjustments and a corrected statement of profit and loss:

Alpha Betical Company, Inc., operates a department store in a Midwestern city. Inventories of certain departments—restaurant, candy, bakery, etc.—are valued on the basis of cost and have been reduced to the lower of cost or market. The inven-

tories of the remaining sections are computed on the retail-inventory method. The inventories of the "retail departments" have been taken on the basis of selling prices appearing on the merchandise at the close of business at January 31, 1936, all of the required markdowns having been taken prior to the inventory and the inventory priced accordingly.

Several specialty departments are leased to concessionaires who supply their own merchandise and pay their own invoices. Cash received on cash sales and the collection of charge sales are deposited in the regular bank account of Alpha Betical Company, Inc. The net collections, after deduction of 10 per cent on cash sales and 12½ per cent on charge sales, are remitted to concessionaires monthly.

The profit and loss trial balance for the year ended January 31, 1936, is as follows:

	Debit	Credit
Sales		$1,592,700.00
Returned sales	$ 125,000.00	
Inventory, February 1, 1935	177,000.00	
Purchases (net)	965,000.00	
Provision for shrinkage	12,000.00	
7% loading account		62,090.66
Administrative expenses	99,000.00	
Occupancy expenses	130,000.00	
Publicity expenses	68,000.00	
Buying expenses	48,000.00	
Selling expenses	210,000.00	
Leased department income		17,500.00
Net loss		161,709.34
Totals	$1,834,000.00	$1,834,000.00

Your investigation reveals that:

1. Sales and returned-sales accounts are composed as follows:

	Sales	Returned sales
Sales price:		
Retail departments	$1,527,700.00	$122,200.00
Cost departments	30,500.00	800.00
Additional charge for retailers' occupation tax:		
Retail departments	32,500.00	1,850.00
Cost departments	2,000.00	150.00
Totals	$1,592,700.00	$125,000.00

2. Sales of leased departments of $155,000 and returns of leased departments of $14,500 are excluded from sales and returned-sales accounts.

3. Inventory at February 1, 1935 is composed as follows:

Cost departments	$ 1,700.00
Retail departments (including loading of 7% on net cost)	175,300.00

4. Aggregate selling prices of February 1, 1935 inventory amounted to $295,000.

5. Purchases consisted of following:

Purchases, cost departments (net)	$ 15,900.00
Purchases, retail departments (net)	887,009.34
7% loading on net cost of purchases, retail departments	62,090 66

6. Aggregate selling prices of net purchases for retail departments amounted to $1,640,000.

7. Inventories at January 31, 1936 were:

Cost departments, at lower of cost or market	$ 2,100.00
Retail departments at selling prices	476,000.00

8. Additional markup on purchases of $20,000 were taken during the year.

9. Markdowns amounted to $58,000, and markdown cancellations to $2,500, during the year.

10. The reserve for loading account showed a balance of $11,468.22 as established at January 31, 1935, to reduce inventory to cost.

11. Reserve for inventory shrinkage account at January 31, 1936, shows a balance of $12,000 accumulated by monthly provisions based on a percentage of sales.

SECTION XIX

COST ACCOUNTING

Problem 157

(American Institute of Accountants, May, 1937)

On January 1, 1936, Henry James, owner and operator of several oil properties, started a new venture with $80,000 cash. A few days later he bought from Joseph Wadley the oil rights to a tract of land of 160 acres. He paid $100 an acre cash. In addition he was to pay Wadley the usual royalty of one-eighth of the proceeds from the oil. He also undertook to pay Wadley from the first oil produced one-half of the net proceeds, after allowance for the one-eighth royalty payable to Wadley, until $44,000 had thus been paid.

During 1936 the following expenditures were incurred for drilling and equipment:

Drilling cost of five wells (completed)	$46,500	
Drilling cost of sixth well (not completed)	3,740	$50,240
Casing and tubing, 5 wells at $4,200	$21,000	
Pull rods, pumping jacks and other equipment	1,800	
Equipment of pumping plant	5,800	
Power house covering pumping plant	1,200	
Tanks	3,700	33,500

All of this was paid in cash, except $9,000 which was still owed to the contractor at December 31, 1936, for drilling.

Four of the five completed wells were producers but one was ruined and plugged, with casing valued at $1,600 lost in the hole.

All the oil produced was sold at $1.13 a barrel. The total production was 49,230 barrels and the proceeds from all but 4,360 barrels had been collected at December 31, 1936.

The year's operating costs were:

Labor	$ 3,650
Oil, gas and grease	1,356
Repairs	1,685
Supplies	785
Water	640
Taxes	460
Insurance	760
Trucking and teaming	395
Auto and travel	771
General expense	398
Total	$10,900

Of this amount the following sums were owed at the close of the year:

Labor	$ 360
Repairs	565
Supplies	155
Water	40
Taxes	220
Insurance	260
Total	$1,600

Depreciation is to be written off at the rate of 6½% per annum, computed on one-half of the cost of the equipment, not including drilling costs which will be written off under the general provision for depletion.

Depletion is allowed, for income-tax purposes, at the rate of 27½ per cent of the sales less royalties. However, the actual depletion is covered by 13 cents per barrel as determined by engineer's survey, and was charged to the operations at that rate.

At the close of the year James sold the lease with all equipment, supplies, development, leasehold rights and leasehold obligations to William Brown for $175,000. James assumed all outstanding current liabilities, including the amount payable Wadley upon collection of the proceeds from the 4,360 barrels not yet paid by the purchaser of the oil. However, Brown was to pay Wadley the balance of the $44,000 lease liability out of the net cash proceeds from future oil sales, and Wadley relinquished all claims upon James under the lease.

Prepare a work sheet showing the record of the year's transactions and James's assets and liabilities on December 31, 1936.

before and after the sale to Brown. Show on the work sheet the division of James's profit between taxable and non-taxable operating profit and the profit on the sale of the property.

Problem 158

(Wisconsin, November, 1934)

The following data relative to the Harold Manufacturing Company are submitted for your consideration:

Trial balance, January 31, 1934

Cash	$ 23,171	
Accounts receivable	27,201	
Reserve for bad debts		$ 850
Raw material inventory, January 1, 1934	6,600	
Work in process inventory, January 1, 1934	3,900	
Finished goods inventory, January 1, 1934	7,408	
Land	8,000	
Buildings	24,000	
Machinery and equipment	100,000	
Reserve for depreciation		12,480
Unexpired insurance	1,656	
Prepaid taxes	2,190	
Accounts payable		20,468
Accrued labor, January 1, 1934		400
Capital stock		170,000
Surplus		10,000
Sales of finished goods		36,972
Returned sales and allowances	1,830	
Discount on purchases		311
Materials purchased	26,169	
Factory labor	11,566	
Power	966	
Miscellaneous supplies	1,972	
Selling expense	2,480	
General office expense	2,182	
Sales discounts	190	
Totals	$251,481	$251,481

The factory records furnish the following information for the month:

Raw material requisitioned	$12,968
Goods completed and transferred to finished stock at cost	24,172
Shipments of finished stock at cost	17,600
Cost of sales returns	1,195

Of the factory labor, $3,468 is indirect labor
The accrued labor on January 31 is $610

The following schedule shows the distribution of expenses to the various departments:

Accounts to be debited	Accounts to be credited									
	Totals	Labor	Building expense	Power	Unexpired insurance	Prepaid taxes	Reserve for depreciation	Repairs	General factory expense	Miscellaneous supplies
Building expense	$ 1,017	$ 370		$ 168	$ 24	$ 40	$ 80	$ 130		$ 205
Power	714	600			14	20	80			
Repairs	1,177	712			4	5	26			430
General factory expense	936	186	$ 152							598
Factory burden—department 1	2,245	493	203	504	24	30	150	318	$311	212
Factory burden—department 2	2,863	502	257	672	32	40	200	495	415	250
Factory burden—department 3	1,631	371	203	336	14	17	87	230	210	163
Selling expense (shipping)	474	234	101		2	3	16	4		114
General office expense	177		101		28	32	16			
Totals	$11,234	$3,468	$1,017	$1,680	$142	$187	$655	$1,177	$936	$1,972

Departmental factory burden is distributed to production on the basis of direct labor hours and at the rates indicated.

	Hours	Burden rate per hour
Department 1	3,600	$0.70
Department 2	5,050	$0.50
Department 3	8,800	$0.15

It is also desired to reserve an additional one-half of 1 per cent of net sales as provision for bad debts.

From the foregoing prepare:

1. Work sheet clearly showing the adjustments to the trial balance items and with columnar balances indicating:
   a. Cost of goods sold.
   b. Net profit for the month.
2. Detailed profit and loss statement for the month.
3. Balance-sheet, January 31, 1934.

Problem 159

(Ohio, May, 1930)

The T. Y. C. Manufacturing Company engaged you to prepare their annual financial statements for the year 1929 and submitted the following trial balances and information:

General office trial balance

Cash	$ 500.00	Sales	$875,000.00
Accounts receivable	150,000.00	Interest earned	300.00
Notes receivable	5,000.00	Interest earned—securities	1,350.00
Factory control account	780,000.00	Discounts earned	5,500.00
N. Y. sales office control account	75,000.00	Notes payable	70,000.00
		Accounts payable	111,500.00
United States securities	30,000.00	Depreciation reserve	75,000.00
		Capital stock	650,000.00
Land	25,000.00	Surplus	148,350.00
Office building	25,000.00		
Factory building	175,000.00		
Office fixtures	5,000.00		
Factory machinery and equipment	350,000.00		
Salaries—officers and employees	36,500.00		
Office expenses	5,000.00		
Shipping-department expense	12,500.00		

General office trial balance—(*Continued.*)

Advertising	$ 37,500.00		
Salesmen's salaries and expense	50,000.00		
Sales-office expense	5,000.00		
Incoming freight	7,500.00		
Discounts allowed	5,000.00		
Interest on items payable	3,750.00		
Donations	2,500.00		
Corporation life insurance premium	1,250.00		
Finished goods, January, 1, 1929	150,000.00		
Total	$1,937,000.00	Total	$1,937,000.00

Factory ledger trial balance

Work in process, January 1, 1929	$ 87,500.00	General office controlling account	$780,000.00
Raw materials	65,000.00		
Materials purchased	275,000.00		
Productive labor	167,500.00		
Nonproductive labor	100,000.00		
Insurance	8,750.00		
Taxes	3,500.00		
Heat, light and power	22,500.00		
Repairs	28,000.00		
Other manufacturing supplies and expense	22,250 00		
Total	$780,000.00	Total	$780,000 00

New York sales office trial balance

Cash	$ 1,000.00	General office controlling account	$ 75,000 00
Accounts receivable	34,000.00	Sales at 20% above General office selling value	135,000.00
Purchases at general office selling value	175,000.00		
Total	$210,000.00	Total	$210,000 00

Inventories and deferred and accrued items were not included in trial balance and were as follows:

Prepaid office expenses	$ 125.00
Prepaid shipping expense	312.50
Prepaid insurance expense	1,250.00
Prepaid manufacturing supplies and expense	2,250.00
Inventory finished goods, December 31, 1929 general office	150,000.00
Inventory finished goods, December 31, 1929 sales office	?

Inventory work in process, December 31, 1929	$ 62,500.00
Inventory raw materials, December 31, 1929	75,000.00
Accrued office salaries	1,212.50
Accrued advertising	2,000.00
Accrued salesmen's salaries and expense	1,875.00
Accrued interest	450.00
Accrued productive labor	7,500.00
Accrued nonproductive labor	3,750.00
Accrued taxes	2,000.00

Provide depreciation on buildings at the rate of 3 per cent per annum and 10 per cent per annum on other depreciable assets and charge off bad accounts amounting to $4,000.

From the foregoing you are to prepare:

1. Balance-sheet as at December 31, 1929, after making provision for federal income taxes.
2. Profit and loss statement for the year.

Problem 160

(Wisconsin, November, 1937)

You have been engaged to make an audit of the Big Machine Manufacturing Company, and you determine that the work can be done by yourself and one assistant. The scope of the audit will be stated briefly in your report thus: "I have examined the financial condition of the Big Machine Manufacturing Company as of December 31, 1936, and have made audit tests of its transactions for the year ended that date."

The company's general-ledger trial balance as of December 31, 1936, before closing is as follows:

	Debit	Credit
Cash in banks (three accounts)	$ 110,000	
Petty cash	500	
Bank account—factory payroll	1,500	
Bank account—office payroll	800	
Bank account—dividends		
Stocks and bonds owned	100,000	
Notes receivable	75,000	
Notes receivable discounted		$ 2,500
Accounts receivable—trade	290,000	
Officers' and employees' accounts	1,500	
Reserve for bad debts		7,500
Wisconsin unemployment insurance fund	25,000	
Interest accrued on notes receivable	1,500	
Prepaid insurance premiums	15,000	
Factory ledger account (see page 330 for details)	1,450,000	

	Debit	Credit
Reserve for obsolete inventory		$ 75,000
Land	$ 190,000	
Buildings	875,000	
Reserve for depreciation—buildings		510,000
Machinery and all other equipment	2,575,000	
Reserve for depreciation—machinery, etc		1,950,000
New-machine development	50,000	
Notes payable		75,000
Trade accounts payable		50,000
Accrued salaries and wages		40,000
Accrued commissions		30,000
Accrued property taxes		30,000
Accrued income and capital stock taxes		
Accrued federal unemployment insurance tax		1,000
Reserve for Wisconsin unemployment insurance		27,000
Capital stock (all common)		1,500,000
Surplus		921,050
Dividends paid	90,000	
General profit and loss	2,000	
Profit and loss on capital assets sold	750	
Profit and loss on capital assets scrapped	2,500	
Sales		2,050,000
Discounts on sales	5,000	
Interest earned		3,000
Dividends received		10,000
Miscellaneous income		6,000
Cost of sales	1,385,000	
Discount on purchases		4,500
Development expense written off	40,000	
Bad debts	5,000	
Interest expense	1,500	
Totals	$7,292,550	$7,292,550

Factory ledger trial balance

	Debit	Credit
Material in transit	$ 5,000	
Shop material	135,000	
Foundry material	25,000	
Work in process	530,000	
Finished parts	340,000	
Finished machines	27,300	
Used machines	6,000	
Finished castings	8,000	
Unabsorbed burden—main factory		$ 30,000
Unabsorbed burden—foundry		20,000
Administrative expense	85,000	
Selling expense	345,000	
Inventory adjustments—net	200	

	Debit	Credit
Purchase cost variance		$ 9,000
Shop scrap sold		5,000
Adjustment of job costs to standard	$ 7,500	
General ledger control		1,450,000
Totals	$1,514,000	$1,514,000

Besides the general ledger, the company's books consist of a cash receipts record, a check register, a voucher register, duplicate sales orders and monthly tabulations thereof, a general journal, complete subsidiary records including a plant ledger, a factory ledger and a factory journal. All purchases and expenses not provided for on the general ledger are charged to the factory ledger account, and the distribution of such purchases and expenses is handled on the factory ledger, the detail thereof being recorded on punched-cards. All open accounts on the factory ledger at the end of the year excepting the inventory accounts are closed out by transfer to the general ledger and thence into profit and loss. The company operates with a standard cost system and uses punched-cards throughout. Each month it completes a physical inventory of some portions of its inventory items so that every category is inventoried physically once a year. The directors asked you not to verify or test the quantities or values in the inventory but to make such other inquiry or analysis in respect thereto as you deemed advisable. The company also manufactures a large portion of the machines that it uses in its own plant.

Based on the information given, you are asked to prepare a work schedule or audit program in brief outline form so that it will:

1. Serve as an index for your completed working papers.
2. Indicate what you or your assistant would do under each item included in the program.
3. Indicate whether you or your assistant would do the work scheduled to be done in each instance.

Problem 161

(Pennsylvania, November, 1931)

Given the following summary of accounts of a factory ledger, prepare a statement of cost of sales and a reconcilement of the changes in the general ledger controlling account.

	January 1, 1930 Debit	January 1, 1930 Credit	Net debits	Net credits	December 31, 1930 Debit	December 31, 1930 Credit
General ledger		$1,874,000	$ 287,000			$1,587,000
Finished cabinets, labor	$ 150,000		172,000	$ 239,000	$ 83,000	
Finished cabinets, material	84,000		56,000	103,000	37,000	
Finished cabinets, overhead	255,000		292,000	406,000	141,000	
Cabinet labor in process	121,000		240,000	262,000	99,000	
Cabinet material in process	67,000		81,000	104,000	44,000	
Cabinet overhead in process	206,000		408,000	445,000	169,000	
Finished sets, labor	32,000		42,000	58,000	16,000	
Finished sets, material	20,000		29,000	33,000	16,000	
Finished sets, overhead	44,000		59,000	81,000	22,000	
Sets, labor in process	46,000		82,000	46,000	82,000	
Sets, material in process	35,000		50,000	40,000	45,000	
Sets, overhead in process	65,000		115,000	65,000	115,000	
Finished speakers, labor	46,000		69,000	86,000	29,000	
Finished speakers, material	31,000		55,000	67,000	19,000	
Finished speakers, overhead	69,000		104,000	129,000	44,000	
Speaker, labor in process	92,000		110,000	70,000	132,000	
Speaker, material in process	61,000		72,000	65,000	68,000	
Speaker, overhead in process	136,000		163,000	105,000	194,000	
Stores	314,000		312,000	416,000	210,000	
Overhead distribution				686,000		686,000
Indirect labor			182,000		182,000	
Factory supplies			31,000		31,000	
Spoiled work			28,000		28,000	
Light, heat and power			56,000		56,000	
Maintenance			89,000		89,000	
Depreciation			230,000		230,000	
Small tools			32,000		32,000	
Taxes			24,000		24,000	
Insurance			36,000		36,000	
Totals	$1,874,000	$1,874,000	$3,506,000	$3,506,000	$2,273,000	$2,273,000

Problem 162

(American Institute of Accountants, November, 1932)

You are called upon by the president of a corporation to restate the operating accounts of the company. The chief accountant has recently remodeled the general ledger, introducing accounts for cost of sales, work in progress and other accounts appertaining to the operations. These accounts are maintained in the general ledger, no separate factory ledger having been opened.

At the end of the first month under the new system, the chief accountant has submitted to the president a statement of operations showing:

Net sales	$75,000
Cost of sales	43,700
Operating profit	$31,300

The president has then asked that figures be submitted showing inventories at the beginning, purchases, payrolls, etc., but the chief accountant has met with a serious accident and no one else in the office has been able to furnish the desired information. You are requested to do this.

Show how you would obtain the desired information and state what suggestions you would offer in order that cost of sales could readily be analyzed in the future.

The operating accounts and journal entries are as follows:

LEDGER

Raw materials

Inventory	$30,000	Issues	$25,500
Voucher record	20,000		

Work in progress

Inventory	$20,000	Cost of sales	$43,700
Raw materials	24,000	Power house	320
Stores	10,000	Plant account	1,500
Voucher record	1,500		
Labor	5,150		
Overhead	6,870		

Foundry overhead

Stores	$ 900	Work in progress	$ 1,950
Voucher record	125		
Labor	125		
Power	400		
Depreciation	300		
Insurance	125		
Taxes	75		

General plant expense

Raw materials	$ 1,000	Work in progress	$ 1,170
Stores	1,300		
Voucher record	275		
Labor	225		
Pattern shop overhead	150		
Depreciation	80		
Insurance	25		
Taxes	20		

Labor—Pattern shop

Voucher record	$ 650	Sundries	$ 650

Stores

Inventory	$10,000	Issues	$15,150
Voucher record	7,500		

Pattern shop overhead

Stores	$ 1,150	Work in progress	$ 500
Voucher record	50	General plant expense	150
Labor	75		
Power	240		
Depreciation	100		
Insurance	50		
Taxes	30		

Machine shop overhead

Stores	$ 1,500	Work in progress	$ 3,250
Voucher record	350		
Labor	275		
Power	800		
Depreciation	480		
Insurance	200		
Taxes	75		

Power house

Raw materials—coal, etc.	$ 500	Pattern shop	$ 240
Stores	150	Foundry	400
Labor	350	Machine shop	800
Depreciation	140	General offices	160
Insurance	100		
Taxes	40		
Work in progress	320		

Labor—foundry

Voucher record	$ 1,950	Sundries	$ 1,950

Labor—machine shop

Voucher record	$ 3,250	Sundries	$ 3,250

JOURNAL ENTRIES

1

Work in progress	$24,000	
Power house	500	
General plant expense	1,000	
Raw materials		$25,500
Summary of materials used during month.		

2

Work in progress	10,000	
Pattern-shop overhead	1,150	
Foundry "	900	
Machine-shop "	1,500	
Power house	150	
General plant expense	1,300	
Employees' accounts receivable	150	
Stores		15,150
Summary of requisitions for the month.		

3

Plant and equipment	5,000	
Work in progress	1,500	
Raw materials	20,000	
Stores	7,500	
Employees' accounts receivable	150	
Advertising	700	
Prepaid insurance	1,250	
Pattern-shop overhead	50	
Foundry "	125	
Machine-shop "	350	
General plant expense	275	
Salaries	5,000	

Labor—Pattern shop	$ 650	
" —Foundry	1,950	
" —Machine shop	3,250	
" —Power house	350	
Traveling expense	350	
General expense	650	
Accounts payable		$49,100
Summary of voucher record for the month.		

4

Work in progress	5,150	
Pattern-shop overhead	75	
Foundry "	125	
Machine-shop "	275	
General plant expense	225	
Power house	350	
Labor—Pattern shop		650
" —Foundry		1,950
" —Machine shop		3,250
" —Power house		350
Distribution of payrolls.		

5

Work in progress	6,870	
General plant expense	150	
Pattern-shop overhead		650
Foundry "		1,950
Machine-shop "		3,250
General plant expense		1,170
Distribution of overhead for the month.		

6

Plant and equipment	1,500	
Power house	320	
Cost of sales	43,700	
Work in progress		45,520
Cost of shipments during month.		

7

Power house	280	
Pattern-shop overhead	180	
Foundry "	500	
Machine-shop "	755	
General plant expense	125	
Prepaid insurance		500
Reserve for depreciation		1,100
Accrued taxes (property)		240
For proportions applicable to factory, viz.:		

	Depreciation	Insurance	Taxes	Total
Power house	$ 140	$100	$ 40	$ 280
Pattern shop	100	50	30	180
Foundry	300	125	75	500
Machine-shop	480	200	75	755
General plant	80	25	20	125
Totals	$1,100	$500	$240	$1,840

8

Pattern-shop overhead	$ 240	
Foundry "	400	
Machine-shop "	800	
General office	160	
Power house		$1,600

Distribution of overhead for month.

Problem 163

(New York, October, 1935)

The XY Products Company produces a racing toboggan which sells for $300. An increase of 15 per cent in cost of materials and of 10 per cent in cost of labor is anticipated.

If the only figures available are those given below, what must be the selling price to produce the same percentage of gross profit as before?

1. Material costs have been 45 per cent of cost of sales.
2. Labor costs have been 40 per cent of cost of sales.
3. Overhead costs have been 15 per cent of cost of sales.
4. The anticipated increased costs in relation to the present sales price would cause a 35 per cent decrease in the amount of the present gross profit.

Prepare a profit and loss statement per unit of product, showing the new selling price desired and the new costs per unit.

Problem 164

(American Institute of Accountants, May, 1932)

On the cost ledger of a fabric mill there is maintained a separate account for each department. One, engaged solely in "winding," is known as department C.

Under date of January 1, 1932, the following information was obtained with respect to department C.

The inventory of wound goods, by weight 795.34 pounds, was valued at $4,056.23, and labor in process totaled $79.53. The average cost of material was $5.10 per pound, and the estimated average cost of winding was 10 cents per pound. No unwound goods were on hand either at the beginning or at the end of the month.

The charges to this department for unwound material, during the month of January, 1932, were by weight 3,613.83 pounds and for actual labor expended thereon $415.

The credits for wound goods delivered during the month of January, 1932, were

To department	D	3,612.68 pounds
" "	E	9.10 "
" "	F	60.38 "
" "	G	10 13 "

On the basis of these data, submit the following, as of January 31, 1932:

(a) Ledger account for department C.
(b) Balance of goods in this department and their value, also showing estimated labor thereon.
(c) Difference between estimated and actual cost of labor.
(d) Actual average cost of winding for the month of January.
(e) Total of charges to the succeeding departments on the basis of estimated labor cost.

Problem 165

(American Institute of Accountants, November, 1932)

The superintendent of a cheese manufactory reports the following results of a test-run:

46,153 pounds of milk were purchased at the contract price of $3.10 per cwt., on the basis of a butter-fat content of 3.5 per cent, with a premium or discount of 4 cents per cwt., on account of variations from the standard, the total cost being $1,647.66. From this milk, 5,976 pounds of cream, having a butter-fat content of 20 per cent, were sold at a price of 58 cents a pound of butter fat, the remainder yielding 4,491 pounds of uncured cheese, known as No. 1.

The whey from the milk used weighed 29,280 pounds, to which was added 1,384 pounds of whole milk from the purchases of the following day, the combined fluid yielding 1,821 pounds of uncured cheese known as No. 2.

The No. 1 cheese is subject to a shrinkage of 12.3 per cent in curing, and the No. 2 to a shrinkage of 33 per cent.

From the foregoing data, determine the material cost per pound of cured cheese and the yield per cwt. of milk.

For this purpose, you may assume the value of whey to be 50 cents per cwt., and the price of the whole milk used in the process of the second day the same as that used on the first day.

Problem 166

(American Institute of Accountants, November, 1937)

The Brown Company operates a mill, manufacturing a product X. During October and November, 1936, the mill, because of labor troubles, was forced to operate at reduced capacity.

The production and relative unit costs of X for the six months ended December 31, 1936 were as follows:

	Production	
	Units	Unit cost
July	20,000	$2.20
August	20,000	2.25
September	20,000	2.20
October	2,000	7.50
November	5,000	7.00
December	24,000	2.75

As a result of a labor settlement effective December 1st, the company agreed to pay all its workers a 10% increase in wages. Prior to that date labor cost represented approximately 70% of the total cost of the product. As an additional concession under the labor settlement the company granted a two-weeks' vacation to each employee; these vacations will be taken by the employees on a "staggered" plan, without the employment of any additional labor. No provision has been made in the company's records for this additional concession.

It was determined by the auditor that the expense of police, etc., during the labor difficulties had been properly charged to general expenses.

It is the practice of the company to price its inventory at cost prices established on average bases, predicated upon the production of December, and when the inventory is greater than the production of that month, then the prices are determined retroactively on the basis of the next previous month or months of normal production until a quantity has been obtained equal to

the inventory on hand. The inventory of X at December 31, 1936, was 50,000 units.

At what price should the company's inventory be valued? Show your computations.

Problem 167

(American Institute of Accountants, November, 1933)

In preparing a balance-sheet, to be used in proposed refinancing of a company engaged in the production of wine, which has maintained rather incomplete records, what amount would you use as the value of finished wine on hand, on the basis of the following data?

With respect to the inventory of wine on hand you are able to determine the following:

(1) The average cost of grape juice was \$1.55 per gallon, which approximates present market.

(2) The average cost of brandy, of which 5 gallons were used per 50 gallon barrel of finished wine, was \$3.75 per gallon.

(3) Filtration loss was stated to be, in the aggregate, about 4 gallons to each 50 gallons—the federal government allows 6%.

(4) The total labor cost to produce 40,000 gallons in one year was \$18,000.

(5) The cost of a 50 gallon barrel was \$5.50.

(6) The plant overhead was about ⅓ of the labor cost.

(7) Shrinkage averaged about 1% per annum.

(8) Carrying charges averaged about 6% per annum.

(9) Of the 20,000 gallons of wine on hand, 5,000 gallons were 15 years old and 15,000 gallons were 6 years old.

Submit a work sheet and explain your reasoning.

Problem 168

(New York, October, 1935)

Four municipalities own and operate a joint waterworks under a special act of the legislature, which provides that each municipality shall fix its own rates, collect its revenues, maintain its distribution system and pay to the Joint Water Board its share of the operating expenses based upon the amount of water used. Because of irregular boundaries, it was impracticable to meter the

water delivered to each municipality, and because of leakage the consumers' meters did not account for all the water delivered. The records of the Joint Water Board show 75,000,000 cubic feet of water delivered to the mains and a total operating cost of $93,750. A summary of the bills rendered consumers shows:

Municipality	Cubic feet	Revenue
A	27,000,000	$50,000
B	9,000,000	22,000
C	12,000,000	30,000
D	12,000,000	28,000

It was agreed that the leakage probably occurred at the pipe joints and that this loss should be prorated according to the size and number of joints (or joint-inches) in the respective distribution systems, which were relatively as follows:

	A	B	C	D
4-inch pipe, linear feet	2,500	3,000	2,500	5,000
6-inch pipe, linear feet	17,000	13,500	5,500	5,000
8-inch pipe, linear feet	4,000	3,000	7,000	5,000

Assuming that the number of joints would be the same in any given number of linear feet of pipe of the same size, prepare a statement showing the distribution of operating costs and the net revenue of each member municipality.

Problem 169

(Ohio, May, 1932)

Following is a trial balance of The Fruit Juice Company (Ohio Corporation) at December 31, 1931:

Accounts payable for purchases, etc.		$ 5,500
Accounts receivable (for bottled product)	$ 25,500	
Accrued payroll		1,000
Automobiles	12,000	
Capital stock outstanding—25,000 shares without par value—stated capital		250,000
Cash	28,300	
Crowns and labels (inventory, December 31, 1931)	17,000	
Inventory of bottled juice, January 1, 1931	1,000	
Inventory of keg juice, January 1, 1931	12,000	
Kegs, cases and bottles on hand (inventory, December 31, 1931)	28,000	
Machinery and tools	104,000	

Prepaid insurance at December 31, 1931	$ 1,500	
Purchased materials, plus January 1, 1931, inventory	195,000	
Real estate and buildings	224,000	
Refund on kegs returned	8,500	
Shop equipment	6,000	
Signs (permanent)	11,700	
Surplus		$247,000
Sales of bottled juice—400,000 doz. bottles		255,000
Sales of keg juice—20,000 kegs (includes 50 cts. for keg)		109,500
Interest earned and sundry income		15,600
Bad debts	2,000	
Expense:		
Pressing	40,000	
Bottling	56,000	
Shipping (including kegs, cases and bottles)	46,900	
Selling	27,000	
Administrative	37,200	
Totals	$883,600	$883,600

All juice is produced at the company's plant and sold in kegs or case lots of two dozen bottles each. Each keg produces twenty-one dozen bottles, and there is no loss from spoilage, leakage or other causes. All kegs are filled in the pressing department. Two thousand cases of bottled juice were on hand January 1, 1931, and the juice sent to the bottling department during the year represented four-ninths of the year's production.

The company's plant was not in operation during January, 1931; however, sales for the month amounted to 4,000 kegs and 2,000 cases.

The unentered inventories at December 31, 1931, were as follows:

Purchased materials	$77,500
Juice in kegs	9,000 kegs
Juice in bottles	24,000 dozen bottles
Kegs in hands of customers, subject to refund of 50 cents each	8,000 kegs

Provision for depreciation has been made by direct credits to asset accounts.

In December, 1931, the company sold a $200,000 first-mortgage serial bond issue at 90 to provide funds for the immediate construction of an addition to the present plant. The bonds were dated December 31, 1931, and mature as follows:

December 31, 1932,	$ 10,000
December 31, 1933,	10,000
December 31, 1934,	10,000
December 31, 1935,	20,000
December 31, 1936,	40,000
December 31, 1937,	110,000

In order to dispose of the bonds, it was necessary for the company to accept 5,000 shares of capital stock (which is to be considered as treasury stock) from the purchaser and give a credit of $40,000 therefor. The stock and the remaining net cash proceeds were received in December, 1931, but no entries appeared on the company's books for any of the items relating to the bond issue.

A dividend of $2 a share, payable January 15, 1932, was declared by the board of directors on December 31, 1931.

1. Classified balance-sheet as of December 31, 1931.
2. Income and expense statement for the year 1931.
3. Statement showing items entering into cost of production and cost of keg juice sales during 1931 and total cost per keg.
4. Statement showing items entering into cost of production of bottled juice and cost of bottled juice sales during 1931 and total cost per dozen bottles.
5. Schedules showing amount of bond discount to be amortized each year, using the method adopted by the U. S. Treasury Department for income-tax purposes.

Problem 170

(District of Columbia, May, 1936)

The Electrical Manufacturing Company manufactures and distributes radios through jobbers. National Distributing Corporation buys radios on a cost-plus contract which contains the following provisions:

1. Electrical Manufacturing Company is to furnish its standard models under the National trade name. These are to be shipped f.o.b. factory as completed.

2. National is to be billed during the year for radios shipped at the following unit prices: model A, $10; model B, $20; model C, $30.

3. Prices are to be adjusted at the end of the year to average factory cost figured at the closest cent per unit plus a 10 per cent allowance to cover shipping, general and administrative expense and profit. In figuring factory cost, average material and labor costs for radios completed during the year are to be used, and burden is to be figured by departments based on annual departmental cost without considering labor and burden in process at the beginning of the year. Any differences disclosed as a result of your investigation are to be prorated between ending inventories and cost of sales on a proportionate basis.

You are requested to prepare:

1. A statement of profit and loss for the year ended December 31, 1935, showing detail of cost of sales. Ignore any provision for federal income tax.
2. A statement of unit costs of production for the year ended December 31, 1935.
3. A statement of the account with National Distributing Corporation as of December 31, 1935.

The trial balance of Electrical Manufacturing Company as of December 31, 1935, follows:

Account	Debit	Credit
Cash	$ 250,000	
Accounts receivable—general	275,000	
National Distributing Corporation	125,000	
Inventories	425,000	
Land, buildings and equipment	1,225,000	
Reserve for depreciation		$ 340,000
Accounts payable		195,000
Capital stock		1,200,000
Earned surplus		550,000
Net sales		3,450,000
Cost of sales	2,900,000	
Burden absorbed in production		705,100
Cabinet-shop expense	231,600	
Machine-shop expense	227,000	
Assembly-department expense	220,200	
Building expense	100,000	
Receiving expense	25,638	
Warehouse and shipping expense	61,500	
Selling and administrative expense	374,162	
Totals	$6,440,100	$6,440,100

Your examination discloses the following facts:

1. Building expense is to be divided on the basis of floor space as follows: cabinet shop, 30 per cent; assembly department, 30 per cent; machine shop, 25 per cent; receiving department, 5 per cent; warehouse and shipping, 5 per cent; and general office, 5 per cent.

2. Inventories at December 31, 1935, as shown by the records, were as follows:

Particulars	Material	Labor	Burden	Total
Raw material	$120,000			$120,000
Work in process:				
Cabinet shop	6,500	$ 6,000	$ 7,500	20,000
Machine shop	7,000	6,000	12,000	25,000
Assembly department	20,000	12,000	13,000	45,000
Finished radios	85,000	55,000	75,000	215,000
Totals	$238,500	$79,000	$107,500	$425,000

3. Finished radio accounts are analyzed as follows:

Particulars	Model A	Model B	Model C	Total
Production transferred from work in process:				
Material	$480,000	$ 922,400	$279,000	$1,681,400
Labor:				
Cabinet shop	44,000	136,000	40,000	220,000
Machine shop	20,000	75,000	15,000	110,000
Assembly department	72,000	156,000	52,000	280,000
Burden:				
Cabinet shop	55,000	168,500	50,000	273,500
Machine shop	40,000	148,000	30,000	218,000
Assembly department	54,000	119,100	39,000	212,100
Totals	$765,000	$1,725,000	$505,000	$2,995,000
Inventory, January 1	10,000	90,000	20,000	120,000
Totals	$775,000	$1,815,000	$525,000	$3,115,000
Sold	750,000	1,700,000	450,000	2,900,000
Inventory, December 31	$ 25,000	$ 115,000	$ 75,000	$ 215,000

4. The statistical records show the following production and sales for the year:

Particulars	Model A	Model B	Model C
Inventory, January 1	1,200	4,500	800
Produced	80,000	100,000	15,000
Totals	81,200	104,500	15,800
Net sales	78,200	98,500	12,800
Inventory, December 31	3,000	6,000	3,000

5. Inventories at January 1, 1935, were as follows:

Particulars	Material	Labor	Burden	Total
Raw material	$ 80,000			$ 80,000
Work in process:				
Cabinet shop	8,000	$ 8,000	$ 9,000	25,000
Machine shop	10,000	4,000	6,000	20,000
Assembly department	30,000	14,000	16,000	60,000
Finished radios	50,000	30,000	40,000	120,000
Totals	$178,000	$56,000	$71,000	$305,000

6. The company maintains perpetual inventories and job costs, using the first-in, first-out basis. Direct labor is charged directly to jobs and reconciled with the payroll records. Burden is charged to jobs on the basis of arbitrary percentages of direct labor which must be adjusted at the end of the year.

7. The physical inventory at December 31, 1935, shows raw material of $115,000, a shortage of $5,000. Work in process is taken from job tickets which are found to be correct as to quantities, and which include material and labor priced at cost. The finished radio inventory is found to be correct as to physical quantities but contains 1,000 model C machines which had been rendered obsolete by engineering changes and which were sold in January, 1936, as a job lot for $20,000.

8. It has been decided to charge the raw-material-inventory shortage to receiving expense and prorate that expense over material placed in production during the year and the remaining raw-material inventory.

9. The account with National Distributing Corporation is analyzed from the books as follows:

Shipments:	
Model A—40,000 @ $10	$ 400,000
Model B—30,000 @ 20	600,000
Model C—10,000 @ 30	300,000
Total	$1,300,000
Payments on account	1,175,000
Balance due	$ 125,000

Problem 171

(New York, October, 1933)

The V-M Lumber Company purchases hardwood logs and manufactures from them certain kinds of lumber. It divides its production into three general classes, grades A, B and C, in

addition to the scrap products, which include slabs, sawdust, etc.

Raw material is purchased at flat prices for large lots and in some cases one lot includes logs from which two or more grades of lumber are produced.

Inventories of each grade of finished lumber are carried at cost. Costs of sales for each grade are based on opening inventories and monthly production costs. Production costs are apportioned so that the unit costs of the three grades of lumber for each month are proportionate to sales prices at the end of the month. No net profit is allocated to scrap sales, but it is estimated that the ratios of selling and general expenses to production costs in connection with scrap are the same as those that would be applicable with respect to the A, B and C grades of lumber before credit to production costs for scrap produced.

Inventories at January 1, 1933, were:

Raw materials—logs	$9,000
Supplies	1,000
Grade A—220,000 feet	4,840
Grade B—300,000 feet	5,400
Grade C—400,000 feet	6,000
Scrap (at sales prices less percentage for selling and administrative expenses)	500

Sales, costs and expenses for the month of January, 1933, were as follows:

Sales—grade A, 120,000 feet	$ 3,600
Sales—grade B, 240,000 feet	6,000
Sales—grade C, 200,000 feet	4,200
Sales—scrap	100
Logs purchased	10,000
Supplies purchased	600
Mill salaries and wages	1,950
Other mill expenses	700
Sales department salaries and expenses	1,000
General and administrative expenses	400

The inventories at January 31, 1933, were as follows:

Raw materials—logs	$16,400
Supplies	1,250
Grade A	160,000 feet
Grade B	180,000 feet
Grade C	290,000 feet
Scrap (at sales prices less percentage for selling and administrative expenses)	$ 650

There was no material in process, either at the beginning or at the end of the month.

The sales prices at January 31, 1933, were as follows:

Grade A	$30 per 1,000 feet
Grade B	25 per 1,000 feet
Grade C	21 per 1,000 feet

Prepare a statement of income and expenses of the V-M Lumber Company for the month of January, 1933; also a schedule showing details of sales, costs and gross profits for each of the three standard grades of lumber. Costs per thousand feet need not be extended beyond *two* decimal places.

Problem 172

(Ohio, October, 1937)

From the following trial balance and supplemental information you are to prepare, for the year ended December 31, 1936:

1. Statement of costs of production, showing all costs per ton of iron produced.
2. Statement of profit and loss.
3. Balance-sheet as at December 31, 1936.
4. Computation of federal income and excess-profits taxes.

Trial balance, December 31, 1936

Cash in bank	$ 150,000	
Accounts receivable	200,000	
Inventories, January 1, 1936	1,079,000	
Advances on ore contracts	25,000	
Land	500,000	
Buildings	285,000	
Furnaces and equipment	2,100,000	
Furniture and fixtures	15,000	
Unexpired insurance	10,000	
Accounts payable—trade		$ 100,000
Note payable—bank, 5 %		50,000
Accrued expenses		60,000
Allowance for doubtful accounts		20,000
Reserves for depreciation		699,900
Bonds payable—5 %		250,000
Reserve for relining		225,000
Capital stock—no-par common 50,000 shares		2,000,000
Surplus		581,000

Trial balance.—(*Continued*)

Sales:			
Pig iron			$5,640,000
Slag			50,000
Miscellaneous income			7,500
Purchases:			
Iron ore	476,000 tons	$2,380,000	
Coke	255,000 tons	1,530,000	
Limestone	105,000 tons	157,500	
Dolomite	35,000 tons	70,000	
Slag	15,000 tons	15,000	
Manufacturing expenses:			
Superintendent, foremen, clerks and timekeepers		66,000	
Stocking		75,000	
Charging		69,000	
Blowing		60,000	
Casting		105,000	
Repairs and maintenance		134,000	
Slag and cinder		20,000	
General and miscellaneous		225,000	
Depreciation		152,900	
Prepaid freight, returns, etc.		95,000	
General and administrative		145,000	
Interest expense		15,000	
Discounts allowed		5,000	
Totals		$9,683,400	$9,683,400

Information furnished:

Inventories	Cost per ton	January 1, 1936	December 31, 1936
Finished pig iron		20,000 tons	15,000 tons
Iron ore	$5.00	125,000 tons	100,000 tons
Coke	6.00	10,000 tons	15,000 tons
Limestone	1.50	12,000 tons	17,000 tons
Dolomite	2.00	8,000 tons	13,000 tons

There were 300,000 tons of pig iron produced during the year 1936.

Provide as reserve for relining and renewals of furnaces 25 cents per ton of iron produced. Charge $20,000 of the expense for repairs and maintenance for the year to the reserve for relining account.

Depreciation is to be revised to conform with rates agreed upon with an internal-revenue agent, charges prior to 1935 being undisturbed. The following figures are submitted for making the necessary adjustments:

	Cost to January 1, 1935	Reserve as of January 1, 1935	Estimated remaining life
Buildings	$ 250,000	$ 30,000	27 years
Furnaces and equipment	1,800,000	360,000	17 years
Furniture and fixtures	15,000	4,500	12 years

Since January 1, 1935, the following additions to capital asset accounts have been made:

	Buildings	Furnaces and equipment
July 1, 1935	$25,000	$300,000
April 1, 1936	10,000	

The new equipment has an estimated life of 20 years. The building additions do not prolong the useful life of the buildings.

Depreciation as shown by the books at December 31, 1936, is as follows:

	Charges for 1936	Reserve
Buildings	$ 11,400	$ 52,400
Furnaces and equipment	140,000	640,000
Furniture and fixtures	1,500	7,500

Twenty per cent of the depreciation of buildings and all of the depreciation of furniture and fixtures is chargeable to administration.

Disregard income tax.

A dividend of $1 per share was paid during the year.

Compute depreciation and taxes to the nearest dollar for each item; costs per ton to the nearest cent.

Problem 173

(Ohio, November, 1932)

The Ohio Electric Refrigerator Company is engaged in manufacturing a six cubic foot electric refrigerator for popular trade and sells its product at a uniform price of $100. You are retained to conduct an audit of the books and records of the corporation for the year ended December 31, 1931. You audited the books for the preceding year. The following trial balance was taken from the books before closing:

Debits		Credits	
Land	$ 25,000	Reserves for depreciation:	
Buildings	200,000	Buildings	$ 8,000
Machinery and equipment	400,000	Machinery and equipment	40,000
Office equipment	20,000	Office equipment	4,000
Salesmen's cars and delivery equipment	12,000	Salesmen's cars and delivery equipment	6,000
Building not used in business	35,000	Building not used in business	1,400
Goodwill	100,000	Sales	1,110,000
Unexpired insurance	18,000	Other income	10,000
Inventories at December 31, 1931:		Notes payable to bank, secured by U.S. Treasury notes	100,000
Raw materials	150,000	Note payable to insurance company secured by cash-value life insurance	10,000
Finished goods	182,910		
Manufacturing supplies	20,000		
U.S. Treasury notes 4% par value $100,000	101,000	Accounts payable—trade	15,000
Cash on hand and in bank	76,000	Accrued commission	2,000
Advances to salesmen and employees	10,000	Accrued payroll	3,000
Cash surrender value of life insurance—officers	17,000	Accrued county taxes	8,000
Accounts receivable—customers	384,000	Capital stock:	
Cost of goods sold or shipped	536,090	Common 7,500 shares, no par	750,000
Selling expenses	180,000	Preferred 3,000 shares 6% cumulative par $100	300,000
Administrative expenses	100,000	Surplus	219,600
Other expenses	20,000		
Total	$2,587,000	Total	$2,587,000

At January 1, 1931, the county real estate and personal taxes for the entire year 1930 amounting to $8,000 were accrued and unpaid. During 1931, these taxes were paid and charged to manufacturing expense. At December 31, 1931, the real estate taxes for the entire year 1931 amounting to $9,000 were unpaid.

The depreciation rates for the class of property owned by the company were as follows:

Buildings	2%
Building not used in business	2%
Machinery and equipment	5%
Office equipment	10%
Salesmen's cars and delivery equipment	25%

On December 31, 1930, the company insured its property for three years at a cost of $18,000. The policies expire December 31, 1933, and all insurance is to be considered as manufacturing expense.

There was no work in process at the beginning and end of the year. There were 5,000 completed units on hand January 1, 1931, 11,100 shipped during the year and 3,900 were inventoried

at the factory on December 31, 1931, at cost according to the cost records which are controlled by the general books.

An analysis of raw materials, finished goods and cost of goods sold per the books revealed the following:

Raw material inventory, January 1, 1931	$100,000
Raw material inventory, December 31, 1931	150,000
Purchases during the year	250,000
Direct labor	150,000
Indirect labor	50,000
Manufacturing supplies	20,000
Power	15,000
Light and heat	4,000
Taxes	8,000
Repairs	10,000
Miscellaneous manufacturing expenses	12,000
Finished goods inventory, January 1, 1931—5,000 units	250,000
Finished goods inventory, December 31, 1931—3,900 units	182,910

You found no errors in the distribution of expenses to selling and administrative.

On January 1, 1931, the company adopted the instalment plan of selling its product and secured permission from the government to compute its income-tax liability on this basis. The adjustment of the records, however, has been deferred awaiting your examination.

The accounts receivable at December 31, 1931, were analyzed and found to have originated as follows:

Goods consigned during 1931	$ 10,000
Sales of 1931	360,000
Sales prior to 1931	14,000
Total	$384,000

Included in other income is the interest earned on the United States Treasury notes amounting to $4,000. The closing market quotation on these bonds at December 31, 1931, was $108\frac{2}{32}$.

The $100,000 loan payable to bank was dated November 1, 1931, due in four months. The interest at 6 per cent was deducted by the bank and when entered on the books was charged to other expense.

According to the minutes of December 1, 1931, the directors declared a dividend of 6 per cent on preferred stock and $1 per share on common stock, both payable on January 15, 1932, to stockholders of record December 20, 1931.

The federal income-tax rate for 1931 was 12 per cent, $3,000 exemption. Compute the tax, and make the necessary adjustment.

Required of candidate:

Balance-sheet as of December 31, 1931.
Statement of profit or loss, year ended December 31, 1931.
Statement of cost of goods sold, showing units, total cost and unit cost, per books and after adjustment, year ended December 31, 1931.
Analysis of surplus, year ended December 31, 1931.
Journal entries to adjust the books of the company.
Working trial balance.

Problem 174

(American Institute of Accountants, May, 1930)

You are engaged by the X Company, Inc., manufacturers of cotton cloth, to prepare (a) statement showing cost per pound of cloth sold, (b) profit-and-loss statement for the year 1929 and (c) balance-sheet as at December 31, 1929.

A trial balance, taken from the books and covering the period from June 19 to December 31, 1929, was as follows:

	Dr.	Cr.
Property—real estate and plant (cost)	$ 676,170	
Investments	378,114	
Cash	86,425	
Accounts receivable	17,444	
Inventories, January 1, 1929:		
Raw material—cotton	69,080	
In process	62,437	
Finished goods	86,940	
Fuel	2,097	
Mill supplies	4,910	
Property maintenance	815	
Purchases—raw material	77,594	
" —fuel	4,600	
Expenses	2,116	
Insurance	1,546	

	Dr.	Cr.
Mill supplies	$ 7,389	
Repairs	3,488	
Property maintenance	2,242	
Taxes	4,023	
Water rent	4,310	
Labor	116,043	
Brokerage	2,770	
Executive salaries	6,400	
Prepaid insurance	2,154	
Bad debts	450	
Yarn account		$ 6,250
Accounts payable		4,362
Sales—finished merchandise		328,757
" —waste		13,250
Reserves:		
For depreciation		384,126
" plant improvement		100,000
Income from investments		8,844
" " rentals		2,233
Wages and salaries accrued		9,128
Capital stock:		
Preferred		400,000
Common		200,000
Surplus and profit and loss		162,607
Totals	$1,619,557	$1,619,557

The items following, representing transactions from January 1 to June 18, 1929 (inclusive), were transferred to the profit-and-loss account as at the latter date:

Sales—finished merchandise		$241,882
Purchases—raw material	$ 71,128	
Fuel	4,760	
Expenses	2,279	
Insurance	2,100	
Mill supplies	7,845	
Repairs	3,764	
Property maintenance	1,285	
Taxes (local)	3,600	
Water rent	4,250	
Yarn account	6,250	
Labor	100,468	
Brokerage	3,001	
Executive salaries	4,400	
Income from investments		6,494
" " rentals		1,946
Totals	$215,130	$250,322

The inventories, by pounds, were as follows:

	Jan. 1 1929	Dec. 31 1929	
Raw material	306,663	150,155	
Goods in process (estimated 50% completed)	101,752	104,287	
Finished product	86,229	23,343	
Purchases of raw material during the year			557,706 lbs.
Waste sales during the year			214,214 "

In the preparation of the cost statement, all manufacturing expenses, with the exception of labor, may be grouped under one caption.

Because of an internal check by processes and accurate waste records, it has been customary to value the inventories on the basis of the cost statement.

Depreciation on fixed assets was determined to be $26,541.

Problem 175

(New York, April, 1934)

From the following data prepare a summary showing the parts delivered to C. L. Corporation during the month of December, 1933, and the amounts receivable therefor, stating separately (1) cost, (2) stated profit, (3) bonus or penalty, if any; include, as a part of the solution as presented, your working papers showing how you arrived at the results appearing in your summary:

The Metal Manufacturing Company has a contract for the manufacture of machine parts A and B for the C. L. Corporation, a manufacturer of machinery.

The contract provides that the C. L. Corporation is to pay the Metal Manufacturing Company the cost of the parts which are delivered to the C. L. Corporation's plant, plus profit of $1 on each part A and profit of 60 cents on each part B, subject to bonus and penalty provisions as follows:

For parts A there is to be paid a bonus (in addition to the $1 previously mentioned) of 50 per cent of the amount, if any, by which the cost of each part is less than the estimated cost of $9, but the total profit on each part is in no event to exceed $3; and there is to be charged and deducted a penalty

(to be applied against the $1 profit) of 50 per cent of the amount, if any, by which the cost of each part exceeds $9, but the total amount of penalty with respect to each part is in no event to exceed the amount of $1.

For each part B the estimated cost is $6, the maximum total profit on each part is $2 and the maximum penalty on each part is 60 cents; otherwise the bonus and penalty provisions in connection with parts B are in accord with those previously stated as applicable to parts A.

It has been agreed that settlements are to be made on or before the tenth of each month, based on finished parts delivered and the cost thereof for the preceding month stated at the nearest full cent. It has also been agreed that plant overhead is to be distributed in proportion to direct labor and that, in making distributions, decimals are to be extended to four decimal places.

The Metal Manufacturing Company's records show that raw materials as follows are required for the manufacture of parts:

	Part A	Part B
Brass	16 lb.	14 lb.
Steel	21 lb.	17 lb.

The Metal Manufacturing Company's records show purchases and costs for the month of December, 1933, as follows:

Brass purchased, at 12 cents per pound	110,000 lbs.
Steel purchased, at 5 cents per pound	30,000 lbs.
Direct labor—part A	$8,787.48
Direct labor—part B	6,768.29
Salary of superintendent	500 00
Salaries of foremen	1,400.00
Other indirect labor	1,600.00
Materials and supplies used	4,256.23
Light, heat and power	4,803.98
Sundry plant expenses	2,741.54
Depreciation	2,959.18

During the month of December, raw materials were put into process as follows:

	Part A	Part B
Brass	49,600 lb.	70,700 lb.
Steel	65,100 lb.	85,850 lb.

Inventories at the beginning and end of the month were as follows:

December 1, 1933:	
Brass—38,000 lb. at cost	$4,560.00
Steel—160,000 lb. at cost	8,000.00
Parts A in process—300 at cost	1,500.00
Parts B in process—200 at cost	600.00
Parts A finished—100 at cost	940.00
Parts B finished—150 at cost	810.00
December 31, 1933:	
Brass—27,700 lb. at cost	3,324 00
Steel—39,050 lb. at cost	1,952.50
Parts A in process—500 at cost	2,250.00
Parts B in process—400 at cost	1,400.00
Parts A finished—none	None
Parts B finished—none	None

All parts not otherwise accounted for were delivered to C. L. Corporation during the month of December, 1933.

No scrap or spoiled work is to be considered in connection with this problem.

Problem 176

(New York, November, 1934)

Required from the following data:

1. Open, operate and close the books of account, filling out properly whatever forms of original and final entry seem necessary and desirable for a complete and satisfactory solution of the situation.
2. Present balance-sheet, December 31, 1933, and profit and loss statement for the period ended on such date.

NOTE.—Pass cash entries through general journal. Distribute all expenses to product.

The Black Manufacturing Company operates an estimating cost system. Estimates on each class of product are verified in harmony with the departmental material and labor classifications and manufacturing expenses. All accounts are found in one ledger. Goods finished and in process are represented by article letters, whereas raw materials are handled separately.

A condensed but complete trial balance of the books May 1, 1933, follows:

Cash	$30,000	
Customers	19,000	
Inventory	11,000	
Machinery, equipment, tools	30,000	
Creditors		$ 8,000
Net worth		82,000
Totals	$90,000	$90,000

The inventory, May 1, 1933, was analyzed as follows:

Article	Material		Labor		Manufacturing	
	Dept. 1	Dept. 2	Dept. 1	Dept. 2	Expenses	Total
A	$1,000	$ 400	$ 420	$230	$ 650	$ 2,700
B	500	350	300	205	505	1,860
C	725	575	725	475	1,200	3,700
Raw material						2,740
Totals	$2,225	$1,325	$1,445	$910	$2,355	$11,000

A schedule of estimated costs, May 1, 1933, was prepared as follows:

Article	Material		Labor		Manufacturing	
	Dept. 1	Dept. 2	Dept. 1	Dept. 2	Expenses	Total
A	$1.26	$0.71	$0.88	$0.50	$1.52	$ 4.87
B	1.63	1.00	2.48	1.66	4.56	11.33
C	2.84	1.03	3.36	2.21	6.07	15.51

Expenditures for the remaining eight months in 1933 were as follows:

Raw material	$55,000
Productive labor:	
Productive Department 1	38,000
Productive Department 2	24,500
Expenses:	
Advertising	1,300

Depreciation	$ 1,500
General salaries	6,000
Insurance	1,360
Light, heat, power	4,300
Miscellaneous factory expense	65
Nonproductive labor	53,406
Postage, telephone, telegraph	225
Professional expense	95
Rent	2,600
Repairs and maintenance	1,000
Stationery and printing	150
Supplies for factory	3,325
Taxes	1,250
Traveling expense	2,400

Cash collected from customers, $158,000; cash paid out to creditors, $59,000.

Raw materials consumed during the period were:

Article	Quantity Department 1	Quantity Department 2
A	7,000	7,000
B	8,000	8,000
C	4,000	4,000

Sales during the period amounted to:

Article	Quantity	Rate
A	8,000	$ 8.20
B	7,180	12.56
C	3,980	25.00

The actual inventory taken December 31, 1933, was:

Raw materials	$7,400
Goods in process as per schedule below	8,024

Article	Material		Labor		Manufacturing expenses
	Dept. 1	Dept. 2	Dept. 1	Dept. 2	
A	$ 800	$ 400	$ 360	$170	$ 583
B	850	555	475	285	836
C	800	440	410	290	770
Totals	$2,450	$1,395	$1,245	$745	$2,189

Problem 177

(American Institute of Accountants, November, 1937)

The Miracle Chemical Company manufacturers two products, Mirachem and Corim. Both are made from the same raw materials in the same proportions. In addition to a difference in packaging, Corim is processed in Department B and Mirachem is not.

The plant of the company is divided into four departments, A, B, C, and D. Materials suffer a shrinkage of 16⅔% in Department A, a shrinkage of 20% in Department B, a shrinkage of 10% in Department C, and no shrinkage in Department D.

The materials are mixed in Department A at a cost for labor and overhead of 10¢ per lb. of finished mixture. The materials used are X which costs $1.10 per lb., Y which costs 15¢ per lb., and Z which costs 40¢ per lb. They are mixed in the proportion of one pound X to eight pounds Y to three pounds Z, comprising the unit for calculation. Assume that materials and packages are purchased in quantities just sufficient to cover the sales requirements.

Labor and overhead in Department B amount to 9¢ per lb. of material delivered to the department.

In Department C an amount of water equal to the weight of the material received is added. Labor and expenses including water in this department amount to 5¢ per lb. of material finished.

Department D is the packaging department. Labor and expenses exclusive of the packages cost 5¢ per lb. of Mirachem handled and 7½¢ per lb. of Corim handled. Packages for Corim holding four ounces of the finished product cost 5¢. Packages for Mirachem of the same size cost 2½¢. Corim is sold at 50¢ and Mirachem at 25¢ a package and the total dollar sales are equally divided between the two products.

General and administrative expenses, including advertising, amount to $90,000 a year.

From the foregoing data prepare a statement of profit and loss in the usual columnar form, showing an aggregate net operating profit of 20% on the sales; also showing for each product the number of packages sold and the gross profit; and for each product and each department the materials and supplies purchased and used as well as the labor and expenses.

Problem 178

(American Institute of Accountants, November, 1935)

Company D makes ferro-chrome at a cost of $127 a ton. The product is sold to Company F at $160 a ton.

Company E makes spiegeleisen (ferro manganese) at a cost of $71 a ton. This is sold to Company F at $90 a ton.

Company F makes steel, some being Bessemer steel and some open-hearth chrome steel, using products of Companies D and E. Its manufacturing statistics show:

Bessemer:	
Materials—	
Pig	105 tons
Spiegeleisen	6 "
Total	111 "
Loss of weight in manufacturing	11 "
Tons of ingots produced	100 "
Chrome steel:	
Materials—	
Pig	65 tons
Scrap	20 "
Ore	10 "
Ferro-chrome	15 "
Total	110 "
Loss of weight in manufacturing	10 "
Tons of ingots produced	100 "

It is further shown that in converting ingots into shapes there is a further loss of 10 per cent of the weight of the ingots.

The inventory of Company F shows:

370 tons spiegeleisen
1,200 tons ferro-chrome
9,000 tons Bessemer shapes
23,000 tons Bessemer ingots
18,000 tons chrome steel shapes
46,000 tons chrome steel ingots.

The total inventories before adjustment are:

Company D	$ 120,000
" E	315,000
" F	7,330,000
Total	$7,765,000

What is the value of the consolidated inventory after eliminating the intercompany profit?

Problem 179

(New York, June, 1932)

In the production of a main product and its one by-product, a manufacturer utilizes six production departments. Raw material, when placed in process, passes first through the reduction department in which it is fused to a clinker mass. Then it passes to the grinding department and next to the mixing department. From the mixing department it passes to the extraction department, at which point the by-product emerges. Both products next pass to the finishing department and to the packing department.

Raw material, when placed in process, is composed of two items, as follows:

X	45 %	costs	$110 per ton
Y	55 %	costs	70 per ton

Material storage and handling cost is computed at 8 per cent of material cost.

In the mixing department, chemicals are added, as follows:

A	25 %	costs	$ 40 per ton
B	60 %	costs	80 per ton
C	15 %	costs	160 per ton

Direct labor cost is computed on tonnage handled in each department.

Direct department expense and indirect department expense are computed as a percentage of direct labor cost.

The following are the direct labor costs and expense percentages:

Department	Direct labor per ton	Direct department expense	Indirect department expense
Reducing	$20	40 %	30 %
Grinding	22	150	30
Mixing	30	250	30
Extraction	24	200	30
Finishing	50	60	30
Packing	36	40	30

In the extraction process, 80 per cent of material placed in process becomes main product. Of the remaining portion which is sent to the finishing department along with the main product, two-thirds thereof comes out as completed by-products. There is no loss in finishing main product.

It takes approximately twice as long to finish by-product as it does main product.

By-product is sold at a net profit of $96 a ton, after consideration has been given to its share of factory costs. No commercial expenses are assigned to by-product.

Main product is sold for $900 per ton. Main product is charged with commercial expenses at the rate of 15 per cent of sales price.

Determine the profit per ton of main product sales.

Problem 180

(New York, April, 1935)

The Precision Foundry and Machine Company began operations June 1, 1934, with an inventory as follows:

1. Material sufficient to manufacture 120,000 pounds of castings.
2. Steel valued at $60,000.

During the month of June 1934, the following transactions occurred:

Foundry.—Castings to the amount of 120,000 pounds were made at an average cost of 12 cents a pound. This total quantity was disposed of as follows:

50 per cent to machine shop at 15 cents a pound.
$33\frac{1}{3}$ per cent to customers direct at 18 cents a pound.
10 per cent defective—valued at 50 per cent of average cost.
$6\frac{2}{3}$ per cent on hand at the end of the month.

Machine shop.—Steel requisitioned during June amounted to $60,000.

Direct labor and manufacturing expense were applied there against:

1. Direct labor at 120 per cent of material cost.
2. Manufacturing expense at 140 per cent of direct labor.

Product quantities were disposed of at cost plus 12 per cent, as follows, exceptions are noted below:

63 per cent to assembly department.
12 per cent to shipping department to meet sales orders.
12 per cent to storeroom.
8 per cent defective—valued at 50 per cent of cost.
5 per cent remained in process—considered as 50 per cent completed.

Assembly department.—The cost of direct labor and manufacturing expense combined equaled 22 per cent of the cost of the product at this point.

Of the product received 85 per cent was completed, delivered to the shipping department and sent out to customers.

Shipping department.—The expense of this department was calculated at 6 per cent of the total cost up to and through the crating of the product.

During the month, one shipment was returned by a customer as defective. The billed price of this shipment was $8,250, whereas its cost price was $5,992.50; this return was found not to be defective, but the return of the product was accepted.

Miscellaneous expense.—Selling expenses were computed as 10 per cent of the total cost to make and ship.

Profit was calculated to be 15 per cent of sales price.

Requirements:

1. Schedule of journal entries with complete explanations.
2. Ledger accounts with postings keyed for ready tracing.
3. Summary showing inventories on hand, June 30, 1934.

Problem 181

(New York, November, 1932)

The Genesee Brick Company started operations January 1, 1931, in a newly purchased and fully equipped plant. The opening trial balance was as follows:

Cash	$13,200	
Clay lands, estimated to contain 2,600,000 tons of clay	40,000	
Plant and equipment, machine-made brick	13,000	
Building and equipment, handmade brick	6,000	
Power plant	1,800	
Kilns	16,000	
Capital stock		$90,000
Totals	$90,000	$90,000

Clay is mined and stored until needed, when it is fed to the brick and tile departments. Machine-pressed brick and hand-molded brick and tile are manufactured.

Under the cost-accounting system installed, the cost of each of the two classes of product is determined separately. The various departmental foremen make daily reports, a summary thereof for the month of January being as follows:

Clay mines	6,800 tons clay mined
Machine-made brick	850,000 9-inch bricks molded
Handmade brick and tile	320,000 9-inch bricks (or equivalent) molded
Kilns	810,000 machine-made bricks set in kilns
	780,000 machine-made bricks drawn from kilns, of which 35,000 are broken
	300,000 handmade bricks set in kilns
	290,000 handmade bricks drawn from kilns, of which 15,000 are broken

The voucher record charges for January are:

General plant expenses—stable and yard supplies	$ 190
Powerhouse—fuel, supplies and repairs	370
Clay mining—powder, supplies, repairs, etc	2,380
Machine-made brick—supplies and repairs	850
Handmade brick—supplies and repairs	460
Kilns—fuel, supplies and repairs	1,695

The payrolls for the month are analyzed as follows:

General plant expense—superintendent	$ 160
—watchmen and yard employees	240
Engineers and firemen	330
Clay miners	1,200
Machine-made brick molders, etc	1,200
Handmade brick molders, etc	980
Kilns—setting, firing, drawing, etc	1,410

Depletion of clay lands and depreciation of capital assets are to be provided for as follows:

Depletion:	
Clay lands	4% per annum
Depreciation:	
Power plant	6% per annum
Kilns	6% per annum
Machine-made brick molding	6% per annum
Handmade brick molding	6% per annum

A reserve for extraordinary kiln repairs is to be provided for at 24 cents per 1,000 bricks set in kilns.

The power used at the clay mines is 30 horsepower, and at the machine-made brick plant 45 horsepower.

The general plant expense will be absorbed by the departments in proportion to the labor in each.

It is estimated that since the handmade bricks require more careful handling and setting, the cost of burning in kilns is 30 per cent more than that of machine-made bricks.

Five and one-fourth tons of clay are required per 1,000 bricks.

Broken bricks are valued at their weight as clay.

Bricks remaining in the kilns at the end of the month are assumed to average one-half burned.

Calculate the inventories for each class of product as of January 31, 1931.

NOTE.—Carry decimals to *three* places only, and adjust. Where necessary, adjust on the last item of each series considered.

Problem 182

(Pennsylvania, November, 1935)

The Mineral Coal Company, which began business January 1, 1934, uses a process cost system. Its mining processes are: mining, which consists of breaking away the coal; hoisting, which consists of hauling the coal to the main shaft and hoisting it to the surface; crushing, or breaking up the coal in readiness for sale. The final operation is loading, in which the coal is loaded on barges and shipped to the trade. Loading is classified as a selling expense but requires a certain amount of the mine overhead and is therefore included in the process cost statement, but the entire cost of loading is included in selling expense in the profit and loss statement.

The expense classification covers the following: *mining*, mining labor, shaft timbering labor, pumping labor, blasting powder, and supplies and expenses; *hoisting*, tramming and hoisting

labor, supplies and expenses; *crushing*, crushing and stockpile labor, supplies and expenses; *loading*, loading labor, supplies and expenses; *mine overhead*, supervisory wages, mine office wages, power and light, general maintenance labor, general supplies and expenses, and fixed charges. Allowances for depreciation of equipment are included in the various supplies and expenses accounts.

Expenses for the year ending December 31, 1934 were:

Mining labor	$519,500
Shaft timbering labor	98,500
Pumping labor	19,500
Blasting powder	28,500
Mining supplies and expenses	94,500
Tramming and hoisting labor	67,500
Hoisting supplies and expenses	24,000
Crushing and stock-pile labor	30,000
Crushing supplies and expenses	13,400
Loading labor	15,000
Loading supplies and expenses	6,500
Supervisory wages	18,000
Mine office wages	26,000
Power and light	10,200
General maintenance labor	32,800
General mine supplies and expenses	5,500
Property taxes	27,000
Insurance	18,500
Interest on mortgage	12,000
Salesmen's salaries	36,000
Selling expenses	6,000
Executive salaries	36,000
Office salaries	20,200
Office supplies and expenses	6,800

The production record for the year showed:

Tons mined	480,000
Tons hoisted	420,000
Tons crushed	380,000
Tons loaded, all of which was sold	350,000

Mine overhead is distributed over the various processes according to the ratio of direct labor cost. The depletion charge has been established at 10 cents per ton.

1. Prepare a process cost statement showing the cost and production of each department, with inventories at the end of the year and the cost per ton at each stage of the process.

2. Also prepare the annual profit and loss statement, based on sales of 350,000 tons for $980,000.

Problem 183

(District of Columbia, May, 1933)

The Arnold Company has the exclusive right to manufacture a product that it sells with optional attachments some of which it also manufactures. For the purpose of determining relative efficiency, the various departments of the business except jobbing are credited with their outputs at prices comparable to those charged by outside suppliers.

Castings from the foundry are machined and assembled in the machine shop. The specialty department manufactures several of the optional attachments sold with the main product. Finished products of the machine shop and specialty department are transferred to the jobbing department for sale to customers.

From the trial balance and information following prepare (1) a balance-sheet and (2) a statement of profit and loss showing departmental gross profit:

Trial balance, December 31, 1932

Account	Debits	Credits
Cash in bank	$ 40,325.62	
Cash on hand	250.00	
Accounts receivable	135,627.48	
Reserve for bad debts		$ 25,628.32
Book inventories, December 31, 1932	108,933.24	
Prepaid factory supplies	2,516 34	
Unexpired insurance premiums	1,596.14	
Unamortized bond discount	5,737.50	
Land	51,125.62	
Building	290,046.91	
Machinery and equipment	175,127.60	
Office furniture and fixtures	15,437.82	
Salesmen's automobiles	10,487.25	
Truck	2,400.00	
Reserve for depreciation:		
Building		40,027.95
Machinery and equipment		53,701.69
Office furniture and fixtures		4,158.71
Salesmen's automobiles		3,993.63
Truck		900.00
Accounts payable		35,087.39
Notes payable		27,963.56

Trial balance.—(*Continued*)

Account	Debits	Credits
Accrued factory payroll		$ 2,780.54
6% first-mortgage bonds		170,000.00
7% cumulative preferred stock, $100 par value		175,000 00
Common stock, $10 par value		200,000.00
Surplus	$ 216,632.80	
Net sales		1,817,562.14
Jobbing purchases	1,265,149.70	
Foundry:		
Purchases	425,114.80	
Direct labor	100,696.80	
Supervision	15,809.96	
Insurance	3,500.98	
Supplies and expense	5,268.41	
Departmental sales		623,588.20
Machine shop:		
Purchases	701,460.59	
Direct labor	88,401.22	
Supervision	10,018.80	
Insurance	4,261.20	
Supplies and expense	2,897.72	
Departmental sales		947,441.60
Specialty department:		
Purchases	146,291.52	
Direct labor	30,022.44	
Supervision	4,286.78	
Insurance	1,081.96	
Supplies and expense	1,598.76	
Departmental sales		230,372 90
Heat, light and power	11,108.96	
Taxes—real estate	12,659.08	
Sales salaries	59,408.91	
Sales expenses	27,762.28	
Officers' salaries	149,280.16	
Office salaries	114,509.78	
Bad debts	18,175.62	
Insurance	10,081.56	
Rent of general office	18,000.00	
Office stationery and supplies	26,409.18	
Other expenses	35,601.68	
Truck expenses	3,650.18	
Interest paid on bonds	7,650.00	
Other interest paid	1,650.28	
Income tax on bond interest	153.00	
Totals	$4,358,206.63	$4,358,206.63

The inventories at January 1, 1932, and December 31, 1932, unadjusted for interdepartmental profit, follow:

Particulars	January 1, 1932	December 31, 1932
Inventories:		
Finished products in jobbing department:		
Outside purchases	$ 24,028.46	$ 17,186.92
Transfers from:		
Machine shop	62,140.77	50,475.09
Specialty department	15,808.52	15,412.69
Raw materials in:		
Foundry	12,268.40	10,068.92
Machine shop (outside purchases)	17,180.91	13,229.40
Specialty department	3,418 91	2,560.22
Totals	$134,845.97	$108,933.24

The interdepartmental billings during the year 1932 were as follows:

	To Foundry	To Machine shop	To Jobbing	Together
By:				
Foundry		$623,588 20		$ 623,588.20
Machine shop	$28,474.35		$ 918,967.25	947,441.60
Specialty department			230,372.90	230,372.90
Totals	$28,474 35	$623,588.20	$1,149,340.15	$1,801,402.70

The complete output of the foundry is transferred to machine shop. The billings by the machine shop to the foundry represent defective castings returned. These were charged to foundry purchases.

Depreciation should be computed at the following annual rates:

Assets	Rate
Buildings	2%
Machinery and equipment	10%
Office furniture and fixtures	10%
Salesmen's automobiles	25%
Truck	25%

An analysis of the fixed asset accounts reveals the following changes during the year:

Assets	Balance—January 1, 1932	Additions during 1932	Balance—December 31, 1932
Building	$278,514.62	$11,532.29	$290,046.91
Machinery and equipment:			
Foundry	59,306.75	3,519.69	62,826.44
Machine shop	76,884.92	10,227.68	87,112.60
Specialty department	23,680.19	1,508.37	25,188.56
Office furniture and fixtures	13,230.85	2,206.97	15,437.82
Salesmen's automobiles	10,487.25		10,487.25
Truck	2,400.00		2,400.00

Certain factory overhead expenses are to be distributed as follows:

Expense	To—Foundry	Machine shop	Specialty
Building depreciation	35%	40%	25%
Heat, light and power	40%	45%	15%
Real estate taxes	35%	40%	25%

The bond issue was floated October 1, 1928, at a discount of 5 per cent and is due October 1, 1938, without prepayments. The bond interest is payable April 1 and October 1. Income tax payable under the 2 per cent tax-free covenant clause should be accrued.

A provision for bad debts was made monthly on the basis of 1 per cent of net sales. A review of the accounts receivable reveals that the reserve at December 31, 1932, to provide for normal losses, should be $28,416.97.

An analysis of the surplus account since January 1, 1931, is as follows:

Particulars	Amount
Balance, January 1, 1931	$232,873.61
Net operating loss—1931	414,819.06*
Balance, January 1, 1932	$181,945.45*
Adjustment to reduce inventories at December 31, 1931, to cost	10,187.35
Total	$192,132.80*
Preferred dividends paid for years 1931 and 1932	24,500.00
Book balance, December 31, 1932	$216,632.80*

* Red.

The truck mileage was used approximately 50 per cent for hauling raw materials to the foundry and 50 per cent for hauling shipments from the warehouse to freight depots.

Selling and administrative expenses are not allocable to the several departments.

Problem 184

(Ohio, May, 1930)

The Valley Lumber and Manufacturing Company began business January 1, 1929, manufacturing wooden cabinets which sold for $6 each.

The company cuts and prepares all lumber used in its operations, having acquired on January 1 a tract of 100,000 acres of timberland for $275,000, $75,000 being paid upon signing of the contract and the balance to be paid $50,000 annually with interest at 6 per cent. The company has a ten-year option to acquire 500,000 additional acres at the same price plus 5 per cent for each year expiring before the option is exercised.

During the year 1929 the company cleared 10,000 acres, being restricted to this amount per annum while the full purchase price remains unpaid. Average recovery has been 3,000 feet an acre. The cleared land is suitable for grazing purposes and has a salable value of 65 cents an acre.

All operations are carried on at the same location. From the sawmill, lumber passes through the dry kiln and yard into the planing mill and then into the cabinet factory, where it becomes a part of the company's product. Shrinkage of material in various operations should be disregarded.

The company's experience has been that 5 per cent of all cabinets manufactured are returned by its customers. These are reworked and sold as "seconds" under a firm contract for $4 each. At December 31 it was estimated there were 500 cabinets in hands of customers to be subsequently returned, and the same ratio of defective cabinets is expected to result from new cabinets ready for shipment.

Inventory on hand December 31, 1929, consisted of the following:

Logs (at sawmill)	500,000 feet
Rough lumber (at sawmill)	400,000 feet

Rough lumber (dried ready for planing) at kiln yard......	1,000,000 feet
Dressed lumber (completely processed) at planing mill....	2,000,000 feet
New cabinets ready for shipment......................	20,000 feet
Seconds (reworked cabinets)............................	1,000 feet

Based upon negotiations concluded late in 1929, the price of all new cabinets shipped during 1930 would be subject to a discount of 10 per cent.

Depreciation has not been provided for, the proper rates applicable to the year 1929 being indicated with respect to each class of depreciable property.

From the foregoing information and the annexed trial balance, you are to submit (1) balance-sheet as of December 31, 1929; (2) income and expense statement; and (3) schedule showing by departments the unit cost of cabinets. Working papers should be in such form as you would expect of a certified public accountant.

Trial balance, December 31, 1929

	Debit	Credit	Depreciation rate
Accounts payable.		$ 53,487.00	
Accounts receivable	$222,823.00		
Advertising.	28,500.00		
Cabinet factory buildings	40,000.00		3%
Cabinet factory expense	191,360.00		
Cabinet factory labor	243,340 00		
Cabinet factory machinery	42,500.00		8%
Capital stock		400,000.00	
Cash	62,317 00		
Collection expense	2,210.00		
Commissary expense	67,412.00		
Commissary sales		74,370.00	
Dry kilns and yard buildings	20,400.00		5%
Dry kilns and yard expense	39,960.00		
Dry kilns and yard labor	112,590.00		
Employees' houses	40,000.00		3%
Field, mill and factory office expense.	28,000.00		
General office expense	64,300.00		
General repairs and expense	9,600.00		
House rentals		5,280.00	
House repairs and expense	1,345.00		
Interest paid	12,000 00		
Liability insurance	3,500 00		
Logging equipment	12,000.00		15%

Trial balance.—(*Continued*)

		Debit	Credit	Depreciation rate
Logging labor		$140,100.00		
Log railroad		7,500.00		8%
Log railroad expense		30,000.00		
Log railroad labor		26,100.00		
Planing mill buildings		17,200.00		5%
Planing mill expense		22,880.00		
Planing mill labor		33,540.00		
Planing mill machinery		25,000.00		8%
Real estate		10,000.00		
Recreation hall		10,000.00		5%
Return allowances—cabinets		60,000.00		
Reworking "seconds"—expense		1,000.00		
Reworking "seconds"—labor		4,000 00		
Sales:				
Logs	1,500,000 feet		$ 22,500.00	
Rough (green) lumber	600,000 feet		12,000.00	
Dressed (dried) lumber	1,000,000 feet		27,500.00	
New cabinets	210,000 feet		1,260,000.00	
Seconds	9,000 feet		36,000.00	
Salesmen's salaries and expense		69,000.00		
Sawmill buildings		16,000 00		5%
Sawmill expense		26,880.00		
Sawmill labor		43,680.00		
Sawmill machinery		21,500.00		8%
Timberland		75,000.00		
Yard equipment		7,600.00		15%

Problem 185

(Ohio, May, 1931)

The Steel Casting Company submitted the following trial balance and information, requesting you to prepare a balance-sheet as at December 31, 1929, and a profit and loss statement for the year 1929.

Trial balance

Cash on hand and in bank	$ 727.00	Reserve for depreciation buildings, January 1, 1929	$ 1,500.00
Accounts receivable	35,068.00	Reserve for depreciation foundry equipment, January 1, 1929	7,034.80
Notes receivable	1,915.00		
Cash value—life insurance	6,688.00		
Inventory—finished goods, January 1, 1929			

Trial balance.—(*Continued*)

Inventory—in process, January 1, 1929		Reserve for depreciation office equipment, January 1, 1929	$ 250.00
Inventory—melting materials, January 1, 1929	$ 10,000.00	Reserve for depreciation delivery equipment, January 1, 1929	625.00
Inventory—foundry supplies, January 1, 1929	15,000.00	Accounts payable	30,298.20
Melting materials purchased	128,000.00	Notes payable	60,000.00
Foundry materials purchased	162,000.00	Common capital stock	180,000.00
Land	63,704.00	Surplus, January 1, 1929	36,000.00
Buildings (40 years)	60,000.00	Sales (2,500 tons)	531,847.00
Foundry equipment (10 years)	70,348.00		
Office equipment (10 years)	2,500.00		
Delivery equipment (4 years)	2,500.00		
Labor, Department 1	16,588.00		
Labor, Department 2	95,985.00		
Labor, Department 3	19,996.00		
Labor, Department 4	2,297.00		
Labor, Department 5	55,260.00		
Insurance	4,800.00		
Taxes	3,600.00		
Power	11,567.00		
Electrical supplies	496.00		
Repairs	13,580.00		
Superintendence	9,000.00		
General labor	15,400.00		
Office salaries	17,511.00		
Travel and sales expense	9,682.00		
Charity	250.00		
Office supplies and expense	2,398.00		
Shipping and delivery	3,190.00		
Bad accounts charged off	2,505.00		
Interest and discount	5,000.00		
Total	$847,555.00	Total	$847,555.00

General information:

The company's bookkeeper prepared the following schedule showing how the company wished the various items considered:

	Foundry supplies	Depreciation Foundry equipment	Repairs	Direct labor
Department 1 melting	9%	40%	$ 1,386.08	9%
Department 2 pattern and moulding	50%	20%	3.04	50%
Department 3 core	11%	20%	273.04	11%
Department 4 annealing	2%	10%	76.52	2%
Department 5 cleaning and finishing	28%	5%	608.26	28%
General		5%	11,233.06	

Inventories, prepaid and accrued items December 31, 1929, were:

Inventory of melting materials	$18,000.00
Inventory of foundry supplies	17,000.00
Prepaid insurance	400.00
Accrued county taxes	1,200.00
Accrued power	305.26
Accrued general labor	2,346.94
Accrued interest and discount	180.00

Accrued departmental labor equaled the difference between the amounts appearing in trial balance and an amount equal to three and one-third times the total general manufacturing burden.

Inventory of 100 tons was on hand in each department and fully completed by each department.

Included in the insurance account was an item of $800 representing a portion of life insurance premiums paid on policies wherein the company is designated as the beneficiary, the balance having been properly charged to cash value of life insurance.

Included in the tax account was an item of $600 for income taxes paid for year 1928, the balance to be considered as manufacturing burden.

SECTION XX

FIDUCIARIES

Problem 186

(Wisconsin, November, 1935)

The Universal Manufacturing Company was unable to meet the semi-annual interest payment due September 1, 1931, on its 6 per cent first-mortgage bonds and on its 7 per cent gold notes, both issues maturing March 1, 1938; the principal amounts outstanding at the date of default were $3,250,000 and $1,700,000, respectively. At the instance of the indenture trustees, receivers were appointed to take over the assets and to continue the operation of the company as at September 1, 1931. On October 15, 1934, a petition was approved by the court authorizing a reorganization in accordance with the provisions of Section 77B of the Federal Bankruptcy Act. A plan of reorganization, effective March 31, 1935, was approved by the court; included therein were the following provisions for the liquidation of existing obligations:

For each $100 in principal amount of 6 per cent first-mortgage bonds (with September 1, 1931, and subsequent interest coupons attached), new securities to be issued as follows:

> $50 in principal amount of 6 per cent first-mortgage refunding bonds, dated February 1, 1935, and due in ten years, and two and one-half shares of Class A stock of no-par value.

For each $100 in principal amount of 7 per cent gold notes (with September 1, 1931, and subsequent interest coupons attached), new securities to be issued as follows:

> $20 in principal amount of 6 per cent refunding notes, dated February 1, 1935, and due in ten years, and one share of Class A stock of no-par value.

For each $100 of general claims (trade accounts payable, etc., totaling $52,500), new securities to be issued as follows:

$20 in principal amount of 6 per cent refunding notes, dated February 1, 1935, and due in ten years, and one share of Class A stock of no-par value.

For each five shares of outstanding $100-par-value preferred stock (of which there is a total of 25,000 shares), one share of new Class B stock of no-par value will be issued.

The 100,000 outstanding shares of $10-par-value common stock are to be canceled without consideration.

No provisions for interest accruing on the bonds and notes subsequent to September 1, 1931, have been entered on the records of the corporation. A capital-surplus account of $549,367 was created in a prior year through appreciation recognized from an appraisal of the land, buildings and machinery. The earned-surplus account contained a debit balance at December 31, 1934, of $2,163,058.29, which was reduced at March 30, 1935, by the net profit to that date, per books, of $25,119.17. The minutes of the board of directors contain a resolution to charge the earned-surplus deficit at March 31, 1935, subject to adjustments thereto, against the existing capital surplus and the surplus resulting from the reorganization.

The court has approved the fees of attorneys and others, in connection with the reorganization, totaling $275,000, but no entry therefor has been made. The board of directors has also approved the payment of the aforementioned fees along with the following unentered items, which appear to be proper, as charges against the existing capital surplus and the surplus resulting from the reorganization:

Additional provision for losses on deposits in closed banks	$ 150,000.00
Additional provision for bad debts	50,000.00
Write-off of unamortized bond and note discount and expense	63,047.12
Write-off of obsolete inventories	119,000 00
Reduction of book value of abandoned plant to estimated salvage value	2,150,000.00

A stated value has been placed by the board of directors on the new Class A stock of $10 per share and on the new Class B stock of $1 per share.

From the foregoing information prepare the following.

1. Statement of surplus accounts for the three months ended March 31, 1935.

2. Statement showing the obligations liquidated in reorganization, the new securities created and the resulting increment from each class of liability liquidated, as at March 31, 1935.

Problem 187

(Wisconsin, November, 1934)

D. L. Barnes and Company, a manufacturing enterprise, upon petition of its creditors has been reorganized under Section 77B of the Bankruptcy Act.* On October 31, 1934, you were called upon to prepare (1) a balance-sheet for the reorganized company, giving effect therein to certain transactions consummated during the period from November 1 to November 6, 1934; and (2) a statement showing the changes that have taken place in the financial structure, and operations from the date the action started, the latter statement to be of whatever form you believe will best display the facts.

On July 31, 1934, when the petition to the court was filed, the financial position of the company presented to the court by the creditors and believed by them to present a true condition of the company's affairs was as follows:

Assets

Cash	$ 57.13
Customers, less reserve for bad debts of $13,018.78	65,151.36
Merchandise inventory, obsolete or slow-moving stock, at cost	26,430.31
Merchandise inventory, in good condition, at cost:	
Raw materials	18,252.22
Work in process	29,540.01
Finished goods	5,242.54
Prepaid insurance on factory equipment	828.11
Treasury preferred stock—100 shares at cost	6,200 00
Land, at cost	2,000.00
Buildings, at cost, less allowance for depreciation of $65,285.93	145,266.62
Machinery, at cost, less allowance for depreciation of $101,798.82	128,276.31
Total	$427,244.61

* Section 77B permits the creditors and stockholders to propose a modification of their respective rights under a plan of reorganization. No specific knowledge of this section is necessary to aid in a solution of this problem.

Liabilities, etc.

5% bank loans	$ 85,000.00
Accrued interest thereon	730.00
Trade creditors (raw materials)	127,208.63
6½% first-mortgage bonds, of which a total of $10,000 is past due	135,000.00
Accrued and past-due interest thereon	17,550.00
Capital stock:	
6% cumulative preferred, on which dividends have remained unpaid for 2 years—1,000 shares of par value of $100 each	100,000.00
Common no-par stock—2,500 shares, no stated value	50,000.00
Deficit	(88,244.02)
Total	$427,244.61

Cash transactions during the three-month period ended October 31 were as follows:

Balance, July 31, 1934	$ 57.13
Receipts:	
Collections on customers' accounts	383,567.81
Sale of all obsolete and slow-moving stock on hand at July 31	10,500.00
Sales of scrap	862.50
Total	$394,987.44
Disbursements:	
Factory wages	$ 61,803.03
Raw-material purchases	89,867.93
Factory expenses	65,056.06
Administrative and selling expense	33,711.90
Bank loan in full, including interest	86,645.00
Trade creditors at July 31	12,720.86
Defaulted bonds, including all accrued and past-due interest of $19,012.50 to September 30, 1934	24,012.50
Balance, October 31, 1934	21,170.16
Total	$394,987.44

The plan of reorganization drawn up by the creditors and approved by all interested parties and by the court involves the following changes in the existing corporation, all of which were carried out during the period between November 1 and November 6, 1934:

1. The old management is to be displaced by a new group to be headed by the trustee who represented the court during the proceedings and who has been allowed a compensation of $2,400 by the court for the three-month period (paid November 5).
2. Bondholders, including the owners of the five $1,000 bonds still in default, will receive cash (payment made November 5) for any unpaid accrued interest at October 31, 1934, and one share of 5 per cent noncumulative preferred stock of $100 par value for each $200 in face value of bonds.
3. The balance owing the trade creditors of July 31 will be settled in full through the distribution to them, on an approximately pro-rata basis, of 5,725 shares of no-par-value common stock.
4. Preferred stock outstanding at July 31 is to be turned in and exchanged for 3,000 shares of no-par-value common stock: treasury preferred stock is to be canceled.
5. Common stock outstanding at July 31 is to be turned in and exchanged for 500 shares of no-par-value common stock.
6. The terms and shares of authorized preferred and common stock are to be modified through application to the secretary of state to agree with the preceding terms.
7. The existing earned-surplus deficit is to be continued.

Assets at October 31, 1934, were to be valued thus:

Receivables, at book value:	
Accounts at July 31, 1934, less same reserve for bad debts of $13,018.78	$ 2,025.10
Accounts representing unpaid sales for 3 months ending October 31, 1934, less estimated uncollectible portion of $10,177.25	48,968.73
Inventories, at cost:	
Raw materials	15,360.71
Work in process	18,804 60
Finished goods	16,502.18
Prepaid insurance on factory equipment	683 22
Fixed assets—on basis of old cost less depreciation, to be decreased by additional allowances for 3-month period on	
	Annual rate
Buildings	2½ %
Machinery	10 %

Trade creditors for raw materials, $62,348.96, constitutes the only liability at October 31, 1934, resulting from the operations of the three-month period.

Problem 188

(Pennsylvania, November, 1935)

Following is the trial balance of Capital Industries Company, Inc., a Pennsylvania corporation, at December 31, 1934, after closing:

Cash	$ 25,000	
Trade accounts receivable	15,000	
Trade notes receivable	85,000	
Reserve for bad debts, trade accounts and notes receivable		$ 8,000
Inventories	125,000	
Miscellaneous accounts receivable (officers, employees and others)	5,000	
Reserve for bad debts—miscellaneous accounts receivable		1,000
Stocks (unlisted stock in Pennsylvania Corporation)	1,000	
Cash-surrender value of life insurance policy on life of officer	20,000	
Plant and equipment	650,000	
Reserve for depreciation		340,000
Deferred charges	6,000	
Notes payable		420,000
Trade accounts payable		27,000
Accrued expenses		12,000
Preferred stock authorized (6% cumulative 2,500 shares of $100 par value)		250,000
Common stock authorized (7,500 shares of $100 par value)		750,000
Common stock unissued	100,000	
Deficit	776,000	
Totals	$1,808,000	$1,808,000

The company had filed in September 1934 an original petition in bankruptcy under the National Bankruptcy Act and had submitted a plan of reorganization under the amendment of June 7, 1934, known as Section 77B. By decree of the United States District Court, trustees had been appointed with authority to continue operations and proceed toward the plan of reorgan-

ization outlined in the petition. The plan of reorganization contemplated the organization of a new company to acquire all the assets of the old company and assume all liabilities of the old company, except liability to noteholders and to shareholders.

Refunding of notes payable was provided for as follows:

1. Liability to be reduced to 60 per cent of present indebtedness to be funded by five-year 4 per cent cumulative income bonds issued by the new company.
2. In addition to these bonds, note creditors are to receive 4,200 shares of common stock of no par value in the new company.

Refunding of liability to stockholders was provided for as follows:

1. Preferred shareholders to receive one share of common stock of no par value in the new company for each share of preferred stock held in the old company.
2. Common shareholders to receive one share of common stock of no par value in the new for each five shares of common stock held in the old company.

The name of the new company under the foregoing plan was to be Capital Industries, Inc.

The procedure outlined in the plan of reorganization will result in a distribution of the entire authorized common stock of the new company, [illegible] 8,000 shares of no-par value.

The saving in interest charges effected by this reorganization will more than offset the loss incurred in the year ended December 31, 1934, of $12,000, and it is believed that with the resumption of demand for capital goods the company will be enabled to retire their debenture income bonds and resume dividend payments.

Pursuant to the plan outlined above, acquiescence had been received from noteholders representing $300,000 of the note liability and from a majority of both the preferred and common shareholders. No consents were received from other creditors.

The estimated cost of reorganization is $5,000. No provision had been made on the books of the old company (a manufacturing corporation) for federal and Pennsylvania capital stock taxes.

The notes were all held by banks or nonresident individuals and were not subject to Pennsylvania loans tax. Federal capital stock tax was reported as at June 30, 1934, on a value of $250,000.

From the foregoing information:

1. Prepare and submit a balance-sheet of the new company giving effect to the proposed reorganization.
2. Show in detail journal entries with adequate explanation closing the books of the old company.
3. State whether the district court may approve this plan and order the assets sold to the new company on the basis of the consents received from creditors and shareholders.
4. State the amount of federal original issue and transfer taxes required, if any, to complete the reorganization.

Problem 189

(American Institute of Accountants, November, 1933)

The "A" Corporation (New York), with a branch in Philadelphia, has a wholly owned subsidiary, the "B" Corporation which was forced into bankruptcy on June 30, 1933. The creditors of "A" Corporation formed a committee, following the application by the Dexter National Bank, Philadelphia, against its loan, of the company's balance of cash on deposit with the bank.

The following trial balances after closing, June 30, 1933, and other data were furnished to the committee by the company:

"A" Corporation (New York books)

Cash—New York Trust Co.	$ 1,524	Notes payable—Dexter Natl. Bank, Philadelphia	$20,000
Securities, at cost (pledged)	14,650	Loans payable—secured, per contra	12,500
Furniture and fixtures	1,000	Capital stock	25,000
Capital stock—"B" Corp.	7,500		
Advances—"B" Corp.	14,640		
Advances—Phila. branch	15,680		
Deficit—per books	2,506		
Total	$57,500	Total	$57,500

The pledged securities have a market value of $5,200 and the furniture and fixtures an appraised value of $300.

Philadelphia branch (Philadelphia books)

Cash—Dexter Nat'l. Bank, Philadelphia, per bank statement	$ 1,580	Accounts payable	$19,060
Accounts receivable	10,000	Wages payable	1,550
Merchandise inventory, June 30, 1933	9,500	Taxes payable	800
Furniture and fixtures	7,500	Due to "A" Corp.	15,680
Profit and loss	8,510		
Total	$37,090	Total	$37,090

The sale of the assets should realize the following: accounts receivable $6,200; merchandise $4,675; furniture and fixtures $2,500.

The cost of liquidation for New York and Philadelphia should be about $4,000.

Receiver and trustee administrative expenses are estimated at $5,000. Cheques for $4,520 to merchandise creditors, on which payment was stopped when bank applied cash on deposit against its loan, have not been adjusted on the above trial balance.

"B" Corporation—Alleged bankrupt
Assets are at estimated realizable value

Accounts receivable	$ 5,582	Overdraft—Camden bank	$ 1,600
Land and building	9,860	Loan payable—Camden bank	7,000
Merchandise inventory, June 30, 1933	7,500	Store wages payable	540
Furniture and fixtures	1,230	Office salaries payable	200
John Doe, president—loan account	300	Executive salary payable—President	1,800
Deficit	34,388	Mortgage payable	12,000
		Mortgage interest accrued	240
		Real estate taxes payable	530
		Accounts payable	12,810
		"A" Corporation	14,640
		Capital stock	7,500
Total	$58,860	Total	$58,860

The salary of John Doe, the president, is $6,000 per annum. The store wages and office salaries are for the two weeks ending June 30, 1933. The "A" Corporation is guarantor on the mortgage and "B" Corporation is on the mortgage bond.

Having engaged your services, the committee has instructed you to prepare, from the above information, statements showing

(a) the probable amount which should be available for unsecured claims against "B" Corporation, and (b) the probable amount which should be available for creditors of "A" Corporation in the event of liquidation.

Problem 190

(New York, April, 1937)

A receiver is appointed for the X Y Z Corporation, October 1, 1935, at which time the corporation's books show the following condition:

Cash	$ 32,000	
Notes receivable	38,000	
Accounts receivable	146,000	
Inventory of merchandise	97,000	
Investments	30,000	
Plant and equipment	290,000	
Notes payable		$ 60,000
Accounts payable		320,000
Capital stock		100,000
Surplus		153,000
Totals	$633,000	$633,000

Accrued expenses, not reflected on the books, amount to $4,700, of which $1,400 is for wages and $2,200 for property taxes.

The investments have a market value of $23,000 and have been pledged as collateral on a note for $20,000.

Accounts receivable of $40,000 have been assigned as security for the other notes payable.

It is estimated that the notes receivable will realize 95 per cent, the assigned accounts receivable 95 per cent and the remaining accounts receivable 75 per cent. It is also estimated that at quick sale the inventory will realize $60,000 and the plant and equipment $100,000. The corporation also owns a patent not shown on the books, which is expected to realize $4,000.

Prepare a statement of affairs and deficiency account.

Problem 191

(American Institute of Accountants, May, 1934)

The H. Manufacturing Company has been losing money for several years and intends to reorganize.

From the following list of accounts as at December 31, 1933, and other information given below prepare a statement of affairs also showing the amounts that will be realized and the estimated losses on realization:

Advances to employees	$ 2,657.44
Cash	4,204.67
Creditors	104,231.33
Creditors, preferred	1,716.20
Customers	200,676.93
Capital stock, common	200,000.00
Capital stock, preferred	150,000.00
Capital stock subscriptions	96,400.00
Deficit	133,893.43
Furniture and fixtures	9,197.26
Goodwill	75,000.00
Inventories	75,693.07
Notes payable	189,663.51
Notes receivable	11,462.50
Plant and machinery	33,860 49
Real estate	2,565.25

The original capital stock was $150,000 preferred and $100,000 common, which was fully paid. The subsequent authorized increase of $100,000 common stock is unpaid, except $3,600. The remaining $96,400 is due from wholly insolvent subscribers. The company has assigned $24,072.08 of its customers' accounts, worth their face value, to one of its creditors and estimates that it still has an equity in them of $2,661.81, although this fact does not appear on the books. Of the remaining customers' accounts $46,706 are barred by the statute of limitations and $36,584.03 are more than doubtful. The remaining assets are estimated to be worth as follows:

Inventories	$ 9,996.42
Plant and machinery	22,088.38
Real estate	1,830.25
Furniture and fixtures	6,697.26
Notes receivable	9,823.40

Problem 192

(New York, October, 1935)

From the following data prepare the executor's final accounting for presentation to the court in closing the estate as of August 1,

1935, and compute the executor's commissions for which allowance will be asked. (Disregard federal and state inheritance and estate taxes.)

John Doe died January 31, 1935, leaving assets that were appraised as follows:

Items	Appraised value
Real estate:	
Building A	$25,000
Building B	15,000
Vacant lot 1	3,000
Vacant lot 2	9,000
Home	12,000
Household effects	4,000
Jewelry	2,000
Automobile	1,000
Mortgage receivable—6% interest payable January 1 and July 1	50,000
Cash	5,000

The will provided the following disposition of the estate:

To the widow, Mary—the home and household effects and, for the period of her life, the income from the $50,000 mortgage.

To a daughter, Margaret—the jewelry, automobile and $5,000 in cash.

To a son, John—$5,000 in cash and the building B.

To a son, William—$5,000 in cash and the two vacant lots.

Any assets not otherwise bequeathed were to be given to the widow.

At the death of the widow, the mortgage was to be sold and the proceeds divided equally among the three children.

The executor paid debts of the decedent $700, funeral expenses $900 and legal and probate expenses $1,200.

On July 1, 1935, building A was sold for $27,000 cash, the mortgage interest was received and $1,250 was paid to the widow.

On July 15, 1935, the widow died, leaving her entire estate to Margaret.

On July 31, 1935, all legacies, except the residue, were paid.

The rate for executor's commissions are for receiving and paying out:

5% on the first	$ 2,000
2½% on the next	20,000
1½% on the next	28,000
2% on all amounts over	50,000

Problem 193

(American Institute of Accountants, November, 1932)

Henry White, a partner in the investment-banking firm of Black & White, died on December 31, 1931.

The assets and liabilities of the firm, at that date, were as follows:

Cash in bank	$ 11,526.90	
Life-insurance funds receivable	44,700.02	
Marketable securities	978,663.77	
Notes and accounts receivable	23,268.63	
Bonds of Kiln Lumber Co., bankrupt, at 25 per cent. of par	56,250.00	
Seventy-five per cent interest in logs, lumber, machinery and logging equipment	22,604.25	
Notes payable		$ 500,000.00
Accrued interest		1,500.00
Liability as guarantors of note of Kiln Lumber Co., bankrupt		38,170.31
Accounts payable		14,357.33
Agreement to repurchase $10,000 bonds of Kiln Lumber Co. at 97½		9,750.00
Capital—James Black, 40 per cent		229,294.37
" —Henry White, 60 " "		343,941.56
Totals	$1,137,013.57	$1,137,013.57

James Black, surviving partner, was appointed trustee to continue the business for a limited period of time.

The transactions to September 30, 1932, were as follows:

The amount due for life insurance was collected.

$712,554.07 was realized on securities which cost $619,483.

$3,725 was expended in exercising rights, the original and newly acquired shares being among those unsold at September 30th.

Notes and accounts receivable realized $17,429.30, but of the balance outstanding at September 30th only $1,000 was considered good.

Foreclosure proceedings were instituted on the bonds of the Kiln Lumber Co. In the final settlement, $4,603.97 was realized in cash and the firm acquired a three-fourth's interest in 10,000 acres of timber lands.

The interest in logs, lumber, machinery and logging equipment realized $2,725.09.

A claim receivable for damages, which was pending December 31, 1930, but not entered on the books, was settled for $3,000.

Notes payable, with interest, amounting to $27,500, were paid.

The liability as guarantors of the note of the Kiln Lumber Co. was discharged by payment of $36,149.73.

One $1,000 bond of the Kiln Lumber Co. had been lost or stolen and, therefore, could not be produced. The remaining bonds were repurchased.

The accounts payable, together with an additional item of $1,275 owing at December 31st but not discovered until later, were duly paid.

The sum of $200,000 was withdrawn in the proportion of the partner's investments.

Expenses incurred, exclusive of interest, totaled $7,328.30, of which $432.15 were unpaid September 30, 1932.

Income amounted to $14,732.03, of which $2,500 had not been received September 30, 1932.

Prepare a statement, in suitable form, for the use of the trustee and of the executor of the estate of the deceased partner.

Problem 194

(American Institute of Accountants, November, 1935)

John Gibbon died January 1, 1930, and left his property in trust to his daughter Ethel. The income was to be paid to her as long as she lived and at her death the trust was to go to his nephew, William Gibbon. He appointed John Doe trustee at a fixed fee of $5,000 per annum. All expenses of settling the estate were paid and accounted for by the executor before the trustee took it over.

Ethel died on September 30, 1933, and left all her property in trust to her cousin, Joseph Hart. John Doe was appointed executor and trustee of her estate and he agreed not to make any additional charges for these services. All income was to be paid to Joseph Hart. The estate, which consisted solely of Ethel's unexpended income from the John Gibbon trust, was immediately invested in 4% certificates of deposit.

The property received under the will of John Gibbon on January 1, 1930, was:

10,000 shares of the K. O. Corporation, valued at $100 each.

$300,000 bonds of the K. O. Corporation, paying interest on June 30th and December 31st at 6% per annum.

In the five years ended December 31, 1934, the trustee received the following dividends on the stock:

February 1, 1930	$40,000
" " 1931	40,000
" " 1932	40,000
" " 1933	60,000
" " 1934	60,000

and he made the following payments:

Expenses:		
$100 a month, totaling		$ 6,000
Trustees fees:		
$5,000 per annum, totaling		25,000
To beneficiaries:		
Ethel Gibbon		
1930	$27,250	
1931	35,000	
1932	25,000	
1933	37,000	124,250
William Gibbon		
1933	$17,000	
1934	46,000	63,000
Joseph Hart		
1934		3,000

The surplus income was left on deposit in the bank and drew no interest.

Prepare trustee's accounts covering the five years ended December 31, 1934, showing the beneficiaries' interests.

Problem 195

(American Institute of Accountants, May, 1931)

John Roberts died on June 30, 1926, leaving a will which appointed Jane Walters his executrix.

On July 15, 1926, the will was admitted to probate and an inventory was filed listing the following assets:

Cash in First National Bank		$20,000
100 shares of Atlas stock—cost $15,000:		
Market value, June 30, 1926	$20,000	
" " , July 15, 1926	22,000	
$10,000 par value 6 per cent Colonial bonds:		
Market value, June 30, 1926	11,500	
" " , July 15, 1926	10,800	
Household furniture		5,000
Rolls Royce automobile		8,000

The will provided that James Brown, the faithful servant of Roberts, was to receive $5,000; that Miss L. Ryan was to receive $5,000 par value Colonial bonds; that Jane Walters was to receive the household furniture and the automobile; and that

Tom Green was to receive $5,000, payable out of the testator's account in the First National Bank.

The will further provided that all the assets remaining after the payment of all lawful debts were to be held in trust for Walter Roberts, nephew of the testator. It further stipulated that in the event of there being unpaid debts at the time of death, or if any debts were incurred or losses sustained on the sales of assets subsequent to death, neither the payment of these debts nor the losses should be applied in reduction of the residue, but rather in the following order:

$$\begin{array}{ll} 1 & \text{General legacies} \\ 2 & \left\{\begin{array}{l}\text{Specific legacies} \\ \text{Demonstrative legacies}\end{array}\right\} \text{equal rank} \end{array}$$

The clause creating the trust provided that the net income of the residue be used for the education and support of Walter (nephew) and that upon his reaching the age of twenty-five years, the corpus of the trust be turned over to him, thus terminating the trust.

The interest on the Colonial bonds is payable April 1st and October 1st.

The transactions of the executrix for the year were as follows:

1926			
July	15	Paid preliminary probate expense	$ 100
Aug.	1	Collected dividend from Atlas stock, declared June 15, 1926	400
	15	Ralph Cohen presents a one-year note signed by Roberts on August 15, 1925, in amount $3,000 bearing interest at 6 per cent per annum. Cohen was holding, as security, $5,000 par value Seaboard 6 per cent bonds. The interest on the bonds (coupons), payable October 1st and April 1st, has been collected by Cohen. The court ordered the executrix to pay the note with interest and to take over the bonds. On June 30, 1926, the Seaboard bonds were worth par.	
Sep.	1	Paid funeral expenses	800
	15	Dividend declared on Atlas stock, payable October 15, 1926	400

1926			
Oct.	1	Collected interest on Colonial and Seaboard bonds	
	15	Collected dividend on Atlas stock	
Nov.	1	Paid to guardian of Walter for his education and support	$ 500
Dec.	1	With the consent of the court, the executrix sold the Colonial bonds which were being held for the benefit of Walter, at $110 and accrued interest	
	15	Paid expenses of last illness of testator	1,000
1927			
Jan.	1	With the consent of the court, the executrix purchased $3,000 par value, 6 per cent. Corporation bonds at $98 and accrued interest. Interest payable February 1st and August 1st	
Feb.	1	Paid debts of decedent	3,000
		Collected interest on Corporation bonds	
Mar.	15	Dividend declared on Atlas stock, payable April 15, 1927	800
Apr.	1	Sold 50 shares of Atlas stock, with the consent of the court, at $190 ex-dividend	
		Collected interest on Colonial and Seaboard bonds	
	15	Collected dividends on Atlas stock	
July	15	The court ordered the legacies paid and the residue turned over to the trustees.	

The specific legatees have agreed to furnish the executrix with enough cash to cover charges against their legacies for debts and losses in order that they may take the specific property willed.

You are required to prepare journal and cashbook entries to record the above transactions and submit charge and discharge statements as to principal and income.

NOTE.—The following are acceptable definitions of terms in the problem:

General legacy—a legacy payable out of the general assets of the estate, as distinguished from a demonstrative or a specific legacy.

Specific legacy—a gift by will that specifies a particular thing.

Demonstrative legacy—a legacy to be paid out of a particular amount of money or quantity of other property that is pointed out.

Problem 196

(American Institute of Accountants, November, 1934)

John Jones set up an irrevocable trust for the benefit of his eldest daughter, Joan Jones, to run until 1935, when she would be thirty years old and would receive the principal of the estate outright. If she should die before attaining the age of thirty, the trust would go to her younger sister, Ethel Jones. The net income of the trust could be withdrawn by the beneficiary at any time.

By the terms of the trust agreement John Jones was to be trustee during his life and was to receive a fee of $1,000 a year in lieu of commissions.

Any investments made for the trust were to be subject to the approval of the trustee only and not to be bound by any legal rulings regarding trust investments.

There was paid into the trust by gift from John Jones on January 1, 1921, the sum of $100,000 which was to be invested by the trustee.

On December 31, 1930, Joan died and bequeathed her entire estate to her brother Paul Jones to be held in trust for him. He was to receive the income and had the right of appointment of the principal. John Jones was made trustee and was to receive an annual fee of $1,000 instead of commissions.

The trial balance of John Jones, trustee, at December 31, 1930, was as follows:

Debits	
Cash—principal	$ 7,000
Cash—income	9,550
$300,000 par bonds 4% R. R. & I. due 1955 at cost, investment of principal	275,000
Stocks—2,000 shares of $100 each at cost, investment of undistributed income funds	150,000
Oil Venture Syndicate—investment of undistributed income funds	12,500
Accrued interest on bonds	950
Payments to beneficiary from income during 1930	2,500
Expenses applicable to income for year 1930	1,850
Expenses applicable to principal paid during 1930	1,000
Trustees' fees for year 1930	1,250
Total	$461,600

Credits

Principal of trust—balance January 1, 1930	$275,000
Undistributed income balance January 1, 1930	138,500
Interest on bonds	12,800
Dividends	14,000
Profits on sale of principal investment bonds	9,200
Profits on stocks sold	9,600
Due trustee for fees	2,500
Total	$461,600
Analysis of undistributed income at January 1, 1930:	
Interest received	$ 80,000
Dividends received	89,000
Profits on stocks sold	30,000
Total	$199,000
Expenses charged to income	$ 16,500
Fees to trustee	9,000
Payments to beneficiary	35,000
Total	$ 60,500
Balance December 31, 1930	$138,500
Analysis of principal at January 1, 1930:	
January 1, 1921	$100,000
Increase to principal through sale of investments	190,000
Total	$290,000
Payment of expenses applicable to principal	15,000
Balance December 31, 1930	$275,000

During the three years ended December 31, 1933, the following transactions took place:

On December 31, 1931, the Oil Venture Syndicate was liquidated by receiving (a) 1,000 shares no-par-value stock of the Oklahoma Oil Producers, Incorporated, of which the market value at December 31, 1931, was $10 a share; (b) $6,250 in cash; and (c) $12,500 5% Stanton Oils of California bonds due in 1955 of which the market value at December 31, 1931, was 80.

During the year 1932 the trustee sold $150,000 par value of the 4% R. R. & I. bonds at a net profit of $25,000 and invested the money in U. S. government 3¾% bonds at 100 net.

During 1932 the trustee invested $10,000 of undistributed income funds of the Paul Jones trust in Standard Oil of New Jersey at $40 per share, receiving 250 shares; the expense of the purchase amounted to $50.

On January 25, 1933, the trustee sold $12,500 par value bonds of Stanton Oils of California for $12,500 net and invested the proceeds in Tulsa city 4% bonds at 100 net.

During the three years ended December 31, 1933, there was collected:

Interest on R. R. & I. bonds	$26,321.25
Interest on Stanton Oils of California	625.00
Interest on U. S. government bonds	10,053.75
Interest on Tulsa city bonds	500.00
Dividends on stocks	40,000.00

During the same three years there was disbursed:

Payments to Ethel Jones as beneficiary	$ 6,000.00
Payments to Paul Jones as beneficiary	10,000.00
Expenses paid chargeable to income of the principal trust	4,000.00
Expenses paid chargeable to income of the undistributed income trust	3,500.00
Fees paid trustee	3,000.00
The account payable to trustee at Jan. 1, 1931, was liquidated	

No legal [illegible] was filed by the trustee during the whole period of the trusts.

Prepare statements from which the trustee may file this legal accounting. Disregard all taxes.

SECTION XXI

GOVERNMENTAL ACCOUNTING

Problem 197

(New York, October, 1936)

From the following data concerning the affairs of the city of Blank, prepare:

1. Balance-sheet.
2. Revenue and expense statement.

The budget for the year 1936 contained estimated tax revenues amounting to $900,000 and estimated sundry revenues amounting to $200,000. The amount appropriated by the city council for the year 1936 was $1,050,000.

The final tax duplicate for the year was made shortly after the budget was completed, and it was found that the taxes receivable amounted to $930,000.

During the first six months, taxes were collected to the amount of $915,000. The uncollected taxes were "delinquent."

Sundry revenues collected during the first six months amounted to $65,000.

During the first six months, contracts were executed aggregating $265,000.

During the first six months, open-market orders were issued aggregating an estimated amount of $500,000.

During the first six months, claims were audited and vouchered to the amount of $510,000, of which $350,000 was chargeable to sundry expense accounts and $160,000 to sundry asset accounts and of which $385,000 was on account of open-market orders and $125,000 on account of contracts.

Problem 198

(Pennsylvania, November, 1936)

1. From the figures shown below, representing the debts and offsetting assets of the X County, situated in Pennsylvania,

prepare a statement showing separately the remaining borrowing power, if any, of the commissioners without assent of electors, and the borrowing power with the assent of electors, based upon the last preceding assessed valuation as indicated below:

Indebtedness	
Bonds authorized and outstanding:	
Electors' bonds	$ 2,500,000
Commissioners' bonds	1,900,000
Total	$ 4,400,000
Accrued interest on commissioners' bonds	14,500
Unpaid property damage awards on commissioners' bond projects	25,000
Accrued interest on damage awards	2,250
Unpaid estimates on contracts (commissioners' bonds)	125,500
Note payable (general fund)	40,000
Unpaid operating payroll	13,750
Accounts payable (budgeted)	15,250
Total indebtedness	$ 4,636,250

Offsetting assets	
Cash:	
Sinking funds (electors' bonds)	$ 400,000
Sinking funds (commissioners' bonds)	375,000
Electors' bond funds	400,000
Commissioners' bond funds	245,000
General fund	27,500
Total	$ 1,447,500
Investments (electors' bonds sinking funds)	850,000
Unpaid assessments against property owners (commissioners' bond projects)	48,000
Accrued interest on assessments	4,320
Delinquent and liened taxes collectible	275,000
Accrued interest on delinquent and liened taxes	37,245
Sundry accounts receivable (good)	13,000
Supplies inventory (operating)	27,500
Total	$ 2,702,565
Last preceding assessed valuation	$56,000,000

Article 9, Section 8, of the Constitution of Pennsylvania provides in part as follows:

"The debt of any county, city, borough, township, school district, or any other municipality or incorporated district, except as provided herein, and in section fifteen of this article,

shall never exceed seven (7) per centum upon the assessed value of the taxable property therein, but the debt of the city of Philadelphia may be increased in such amount that the total city debt of said city shall not exceed ten per centum (10) upon the assessed value of the taxable property therein, nor shall any such municipality or district incur any new debt, or increase its indebtedness to an amount exceeding two (2) per centum upon such assessed valuation of property, without the consent of the electors thereof at a public election in such manner as shall be provided by law. . . . "

Problem 199

(American Institute of Accountants, May, 1935)

From the following municipal trial balance at the close of a fiscal year but before closing the books, prepare a balance-sheet, properly subdivided into funds, after giving effect to necessary entries of the general fund and the sinking fund as of the close of the year and to settlements of all inter-fund balances other than permanent advances:

	Debits	Credits
Accounts receivable general fund	$ 3,321 74	
Appropriation balances (unencumbered), general fund		$ 1,117 09
Assessments receivable	72,621.70	
Bond fund cash	2,005 60	
Bond fund balance (unencumbered)		678.00
Bonds payable, general capital account		250,000.00
Bonds authorized and unissued	8,000.00	
Contracts payable, bond fund		4,700.00
Due stores fund from bond fund		1,227 60
Due stores fund from general fund		1,593 96
Due stores fund from other funds	2,821.56	
Estimated revenues	1,500.00	
Fixed property	897,640.00	
Fixed property (income-producing, trust fund)	62,000.00	
General fund cash	1,842.10	
Income account, sinking fund		1,960.00
Interest account, special assessments	620.00	
Loan from general to stores and service fund	25,000 00	
Public benefit receivable (assessment fund)	6,400 00	
Reserve for encumbrances, general fund		2,827 10

	Debits	Credits
Reserve for working capital		$ 25,000.00
Reserve for retirement of bonds		160,000.00
Reserve for uncollectible taxes		2,875.00
Sinking fund cash	$ 1,450 00	
Sinking fund investments	160,000.00	
Sinking fund requirements	1,000.00	
Sinking fund surplus		490 00
Special assessment bonds		80,000.00
Special assessment fund cash	1,872 65	
Stores and service fund working capital (loan from general fund)		25,000 00
Stores and service fund cash	1,408.22	
Stores inventory	15,942.80	
Surplus receipts, general fund		896 00
Surplus, special assessment fund		1,514 35
Surplus invested in fixed assets		647,640.00
Taxes receivable, general fund	6,972.61	
Temporary loans, general fund		3,000 00
Trust funds balance		96,320.00
Trust fund cash	6,820.00	
Trust fund investments	27,500.00	
Vouchers payable, bond fund		3,400.00
Vouchers payable, general fund		1,327.30
Work in process, stores and service fund	4,827.42	
Totals	$1,311,566.40	$1,311,566.40

Problem 200

(American Institute of Accountants, November, 1933)

On the basis of the following information prepare:

1. A balance-sheet of all funds after closing the books at December 31, 1932.
2. A statement of the current surplus of the general fund for the year, showing the revenue, the expenditures and other items increasing or decreasing surplus during the year and the balance of surplus at the end of the year.
3. A statement of income and expense of the water department for the year.

The city of Dowell classifies its accounts under four different funds. The balances in the accounts of those funds on January

1, 1932, and on December 31st of the same year before closing were as follows:

General fund	January 1st	December 31st
Cash	$ 10,162	$ 21,215
1931 taxes receivable	15,676	12,429
Accounts receivable	2,325	3,545
Stores	9,641	9,533
Permanent property	3,154,695	3,154,695
1932 taxes receivable		60,838
Estimated revenue from taxes		225,000
Estimated revenue from miscellaneous sources		62,000
Appropriation expenditures for current purposes		234,398
Appropriation expenditures for capital additions		8,716
Appropriation expenditures for payment of bonds		25,000
Appropriation encumbrances (1932)		5,842
Totals	$3,192,499	$3,823,211
Accounts payable	$ 2,826	$ 5,626
Reserve for 1931 taxes	10,200	10,200
Reserve for orders and contracts	3,286	5,842
Reserve for stores	10,000	10,000
Current surplus	11,492	11,603
Bonds payable	250,000	225,000
Capital surplus	2,904,695	2,929,695
1932 tax anticipation notes payable		25,000
Reserve for 1932 taxes		24,766
Revenue from taxes		222,894
Revenue from miscellaneous sources		64,325
Appropriations		276,000
Estimated budget surplus		11,000
Sale of old equipment		1,260
Totals	$3,192,499	$3,823,211

Water fund	January 1st	December 31st
Cash	$ 6,126	$ 717
Accounts receivable	7,645	5,573
Stores	13,826	12,635
Investments of replacement fund	21,700	24,500
Permanent property	212,604	214,204
Labor and material expense		109,638
Interest on bonds		3,000
Depreciation charge		10,600
Accounts of prior years written off		1,097
Expended for additions to plant		12,460
Totals	$261,901	$394,424

Water fund	January 1st	December 31st
Accounts payable	$ 4,324	$ 4,318
Customers' deposits	1,500	1,600
Replacement fund reserve	21,700	24,500
Operating surplus	21,773	21,773
Bonds payable	60,000	40,000
Capital surplus	152,604	154,204
Services billed		146,867
Deposits lapsed		60
Interest on investments		1,102
Totals	$261,901	$394,424

Assessment fund Improvement No. 50	January 1st	December 31st
Cash	$ 4,653	$ 1,844
Assessments receivable	46,829	33,414
Delinquent assessments receivable	4,826	2,010
Public benefit receivable	5,632	4,516
Interest on bonds		3,000
Totals	$61,940	$44,784
Bonds payable	$60,000	$40,000
Surplus	1,940	1,940
Interest on assessments		2,844
Totals	$61,940	$44,784

Improvement No. 51	January 1st	December 31st
Cash		$ 851
Assessments receivable		21,600
Public benefit receivable		2,400
Total		$24,851
Bonds payable		$24,000
Surplus		390
Interest on assessments		461
Total		$24,851

Trust funds	January 1st	December 31st
Cash	$ 3,216	$ 31
Investments	94,425	99,425
Premium on investments		800
Accrued interest purchased		260
Cemetery maintenance		849
Cemetery expense		2,976
Policemen's pensions paid		3,200
Firemen's pensions paid		2,400
Totals	$97,641	$109,941

Trust funds	January 1st	December 31st
Cemetery endowment fund reserve	$60,000	$ 60,000
Policemen's pension fund reserve	18,691	18,691
Firemen's pension fund reserve	16,824	16,824
Cemetery maintenance fund reserve	2,126	2,126
Profit on sale of investments		600
Undistributed income		4,800
Policemen's pension fund contributions		4,160
Firemen's pension fund contributions		2,740
Totals	$97,641	$109,941

It is the practice of the city to close out the unencumbered balance of appropriations of the general fund at the end of each year. Depreciation on the general property of the city is not entered and accrued interest on investments or on outstanding bonds is disregarded. Income and profit on trust fund investments are distributed 62% to cemetery funds, 20% to policemen's pension fund, 18% to firemen's pension fund.

The cemetery maintenance fund consists of the income from the cemetery endowment fund and is used for cemetery expense. Excess of receipts over disbursements of pension funds are closed to the reserve accounts of the respective funds at the end of each year.

Attention is directed to the following facts and conditions at the close of the year 1932:

(1) 1931 taxes in excess of the reserve against them are to be written off.

(2) Because of the increased uncertainty of 1932 tax collections the reserve on them is to be increased by fifty per cent.

(3) Invoices on all orders and contracts outstanding at beginning of year have been paid with a saving of $111, which has been credited to current surplus.

(4) The old property sold during the year was carried in the accounts at a value of $6,000.

(5) Permanent property valued at $1,820, becoming useless, was discarded during the year.

(6) Replacements of water-department equipment costing $6,200 were made from the replacement fund during the year at a cost of $7,800.

Problem 201

(Pennsylvania, November, 1931)

The following budget was approved by the authorities of the city of A for the year 1930:

Revenues	Anticipated
Surplus revenue appropriated	$ 10,000.00
Miscellaneous revenues anticipated:	
Franchise tax	17,500.00
Gross-receipts tax	10,500.00
Interest on delinquent taxes	4,000.00
Interest on assessment collections	17,000.00
Poll tax	1,200.00
Permits	700.00
Tax searches	300.00
Licenses	500.00
Town-hall rentals	1,400.00
Library fines	100.00
5 % of gross receipts of bus lines	500.00
Local-purpose tax levy	119,700.00
Total	$183,400.00

Appropriations	Appropriated
General government:	
Administrative and executive	$ 8,000.00
Assessment and collection of taxes	2,500.00
Interest on current loans	2,500.00
Town hall	2,800.00
Preservation of life and property:	
Police	23,500.00
Fire	4,000.00
Fire hydrants	4,800.00
Health and charities	300.00
Streets and sewers:	
Cleaning and maintenance of streets	13,000.00
Sewer maintenance	7,000.00
Street lighting	14,400.00
Ashes and garbage	5,000.00
Trees	600.00
Library	4,000.00

*

Debt service:	
Payment of bonds	$ 8,500.00
Sinking fund	2,135.94
Instalment of general improvement bonds	9,713.64
Interest on general improvement bonds	21,918.34
Interest on assessment bonds	41,342.50
Interest on general improvement notes	600.00
Emergency notes	6,740.00
Other purposes (contingent)	49.58
Total	$183,400.00

The City Treasurer received cash from the following sources:

Taxes	$ 95,200.00
Franchise taxes	16,000.00
Gross receipts taxes	10,390.94
Interest on delinquent taxes	5,185.41
Interest on assessment collections	16,016.85
Poll tax	1,406.00
Permits	727.25
Tax searches	213.25
Licenses	314.15
Town hall rentals	1,203.50
Library fines	108 06
5% of bus receipts	336 42
Miscellaneous receipts	3,409.87
Total	$150,511.70

After closing the books, the outstanding general taxes in the amount of $25,589.36 and franchise taxes in the amount of $3,810.77 were considered as collectible accounts receivable.

Revenue deficits are offset against additional revenue realized over amounts anticipated.

The following expenditures were reported by the city treasurer for the year:

General government:	
Administrative and executive	$ 9,186.04
Assessment and collection of taxes	2,341.00
Interest on current loans	1,250.00
Town hall	2,822.81
Preservation of life and property:	
Police	23,919.41
Fire	4,536.96
Fire hydrants	4,686.39
Health and charities	745.28

Streets and sewers:	
Cleaning and maintenance of streets	$ 12,541.46
Sewer maintenance	7,051.44
Street lighting	13,307.95
Ashes and garbage	5,370.47
Trees	544.67
Library	4,000.00
Debt service:	
Payment of bonds	8,500.00
Sinking fund	2,135.94
Instalment of general improvement bonds	9,713.64
Interest on general improvement bonds	17,560.01
Interest on assessment bonds	39,142.50
Emergency notes	6,740.00
Total	$176,095.97

Resolutions were passed for the following transfers from one appropriation account to the other:

To:	
Administrative and executive	$1,186.04
Town hall	22.81
Police	419.41
Fire	536 96
Health and charities	445.28
Sewer maintenance	83.14
Ashes and garbage	389.28
Total	$3,082.92
From:	
Cleaning and maintenance of streets	$ 22.81
Interest on general improvement bonds	3,060.11
Total	$3,082 92

The surplus account as of January 1, 1930, had a balance of $22,562.48. During the year, tax abatements were charged off in the amount of $1,127.44.

Prepare:

1. Statement of revenues for year showing for each account excess revenue or deficit for the year.
2. Statement of expenditures showing for each appropriation account unexpended balances or overexpenditures of appropriations.
3. Analysis of surplus revenue account for the year.

Problem 202

(American Institute of Accountants, November, 1937)

The following is a balance-sheet of the City of Croix at December 31, 1935:

CURRENT FUND

Assets

Cash	$ 15,482.34
Taxes receivable:	
Year 1932	1,917.66
Year 1933	7,308.14
Year 1934	8,133.11
Year 1935	123,170.65
Deferred charges:	
Overexpenditures of 1935 appropriations	437.10
Taxes cancelled—1935	850.00
Total	$157,299.00

Liabilities

Tax revenue notes:	
Year 1933	$ 7,000.00
Year 1934	8,000.00
Year 1935	123,000.00
Accounts payable	17,601.00
Surplus revenue	1,698.00
Total	$157,299.00

CAPITAL FUND

Assets

Cash	$ 17,810.95
Improvements in progress	39,152 62
Deferred charges to future taxation for cost of completed improvements	25,380.00
Total	$ 82,343.57

Liabilities

Serial bonds	$ 26,000.00
Notes payable	49,000.00
Accounts payable	7,343.57
Total	$ 82,343.57

The governing body of the City adopted the following budget for 1936:

Appropriations	
Department of public works	$ 275,450.00
Department of revenue and finance	48,500.00
Department of public safety	535,375.00
Department of public affairs	190,000.00
Department of parks and public property	60,000.00
Interest on bonds	3,500.00
Retirement of bonds	7,000.00
Interest on notes	4,500.00
Overexpenditures of 1935 appropriations	437.10
Taxes cancelled—1935	850.00
Total	$1,125,612.10
Anticipated revenues	
General licenses	$ 10,700.00
Liquor licenses	63,000.00
Interest on taxes	22,000.00
City clerk's fees	700.00
Building permits	2,500.00
Bureau of health fees	5,400.00
Police court fines	3,000.00
Total	$ 107,300.00
Amount to be raised by taxation	$1,018,312.10
Total	$1,125,612.10

The actual amount of taxes levied for the year 1936 was $1,018,603.75.

During the year 1936, improvements in progress costing $30,000 were completed. The notes payable issued to finance the improvements were retired from the proceeds of a serial bond issue which was sold at par.

A statement of receipts and disbursements for the year 1936 follows:

Receipts:	
1932 taxes	$ 1,012.75
1933 taxes	5,475.63
1934 taxes	6,125.47
1935 taxes	115,245.78
1936 taxes	787,375.62
General licenses	10,754.00
Liquor licenses	63,125.00
Interest on taxes	21,900.00
City clerk's fees	725.00
Building permits	2,530.00
Bureau of health fees	5,350.00

Police court fines	$ 2,925.00
Miscellaneous fees	250.00
Tax revenue notes—1936	215,000.00
Total	$1,237,794.25
Serial bonds	30,000.00
Total	$1,267,794.25
Disbursements:	
Department of public works	$ 270,680.00
Department of revenue and finance	47,350.00
Department of public safety	525,250.00
Department of public affairs	187,325.00
Department of parks and public property	59,100.00
Interest on bonds	3,500.00
Retirement of bonds	7,000.00
Interest on notes	4,300.00
Tax revenue notes—1933	7,000.00
Tax revenue notes—1934	6,000.00
Tax revenue notes—1935	114,000.00
Accounts payable—current fund	16,751.00
Total	$1,248,256 00
Improvements in progress	$ 5,900.00
Notes payable	30,000.00
Accounts payable—capital fund	7,343.57
Total	$ 43,243.57
Total	$1,291,499.57

The following bills applicable to the year 1936 were unpaid at December 31, 1936:

Department of public works	$4,000.00
Department of revenue and finance	1,000.00
Department of public safety	9,500.00
Department of public affairs	2,000 00
Department of parks and public property	700.00

From the foregoing prepare a work sheet showing (1) the balance sheet at December 31, 1936, (2) the changes in revenue surplus, (3) journal entries and (4) cash transactions.

SECTION XXII

INSURANCE ACCOUNTING

Problem 203

(American Institute of Accountants, May, 1931)

Mr. Andrews, who is a client of yours and a stockholder of the B Company, although not active in its management, presents to you the comparative statements and other data on the following pages. He advises that he has been a stockholder of this company for several years and has received $1.00 per share in dividends consistently.

The president of the company, who is "getting along in years," has offered to sell him a substantial block of stock at book value and has explained to Mr. Andrews that the loss in 1930 was due to the general depression.

Your client asks you to make a detailed analysis of the statements and give him your opinion as to whether or not it would be a good investment; further, to advise him in detail of whatever may be reasonably interpreted from the statements as to the company's financial condition, efficiency, management policies, and prospects, together with suggestions as to what should be watched or corrected, etc.

List the principal points that you would discuss in a letter to your client.

Regarding the co-insurance clause, show how much the company would collect in cases of a fire loss of $100,000 and one of $600,000.

Note: Although the company deals in stoves, assume that this fact makes no difference as to what might be destroyed by fire.

B Company
Comparative balance-sheets

Assets	December 31 1930	1929	Increase Decrease
Cash	$ 40,000	$ 15,000	$ 25,000
Notes receivable—customers' coal stoves and ranges	17,500	2,000	15,500
Customers' accounts—gas stoves and ranges	65,000	45,000	20,000
Customers' accounts—coal stoves and ranges	140,000	115,000	25,000
Merchandise inventories—gas stoves and ranges	110,000	145,000	35,000
Merchandise inventories—coal stoves and ranges	275,000	225,000	50,000
Totals	$647,500	$547,000	$100,500
Real estate, machinery and equipment: less, allowance for depreciation (a)	375,000	325,000	50,000
Salesmen's drawing accounts	15,000		15,000
Deferred expenses	5,000	2,000	3,000
Totals	$1,042,500	$874,000	$168,500
Liabilities			
Notes payable—bank (secured, for money borrowed)	$ 5,000		$ 5,000
Notes payable—bank (unsecured, for money borrowed)	300,000	$100,000	200,000
Accounts payable and accrued	75,000	50,000	25,000
Totals	$ 380,000	$150,000	$230,000
Capital stock (par value $10)	450,000	450,000	
Surplus	212,500 (b)	274,000 (b)	61,500*
Totals	$1,042,500	$874,000	$168,500
(a) Appraised sound values:			
Land	$ 50,000	$ 50,000	
Foundations	10,000	10,000	
Buildings, machinery and equipment	400,000	340,000	

(b) Regular annual dividend of $45,000 paid during the year.

B Company
Statement of income and expense

	1927	1928	1929	1930
Net sales—coal stoves and ranges	$ 925,000	$ 900,000	$ 825,000	$ 675,000
Net sales—gas stoves and ranges (a)	400,000	500,000	600,000	725,000
Totals	$1,325,000	$1,400,000	$1,425,000	$1,400,000
Cost of goods sold	875,000	960,000	1,025,000	1,026,500
Gross profit	$ 450,000	$ 440,000	$ 400,000	$ 373,500

B Company.—(*Continued*)

	1927	1928	1929	1930
Salesmen's drawings, commissions and expense—coal stoves and ranges........	$ 92,000	$ 90,000	$ 85,000	$ 75,000
Salesmen's (two) salaries and expenses—gas stoves and ranges....	30,000	37,500	50,000	70,000
President's salary......	20,000	20,000	20,000	20,000
Other expenses (including federal income taxes)..............	225,000	225,000	225,000	225,000
Totals............	$ 367,000	$ 372,500	$ 380,000	$ 390,000
Net profit (or loss*).	$ 83,000	$ 67,500	$ 20,000	$ 16,500*

(a) Sold entirely to a utility company and to a mail-order house.

Note.—At December 31, 1930, the company carried blanket insurance coverage on buildings and contents to the total amount of $500,000 with a 90 per cent co-insurance clause.

Problem 204

(American Institute of Accountants, November, 1931)

A fire partly destroyed the building of Company N, resulting in a loss of $20,000. The sound value of the building was determined to be $50,000.

Because of a misunderstanding between the insurance companies and the broker, or negligence on the part of the broker, insurance was carried as follows:

Insurance company	Co-insurance clauses	Amount of insurance
W..........	None	$10,000
X..........	100%	10,000
Y..........	90%	7,500
Z..........	80%	7,500
Total..........		$35,000

The above policies carry a clause to the effect that the insurance company will not be liable for any more of the loss than the ratio which the amount of the policy bears to the insurance, collectible or not.

Compute the amount the assured will receive on each policy.

Problem 205

(New York, April, 1937)

The Johnson Manufacturing Company suffered a fire loss April 15, 1937. Although the books of account were damaged badly, the information shown below was secured from various sources.

Using the material given below, prepare the following:

1. Balance-sheet after the fire.
2. Profit and loss statement for the three and one-half-months period ended after the fire.

Johnson Manufacturing Company
Balance-sheet, December 31, 1936

Assets		
Cash		$ 38,910.15
Accounts receivable		36,205.00
Merchandise inventory		48,000 00
Machinery and equipment	$50,000.00	
Less depreciation reserve	8,602.30	41,397.70
Automobiles		3,805.35
Total		$168,318.20
Liabilities		
Notes payable		$ 5,306.40
Accounts payable		3,719.30
Capital stock		100,000 00
Surplus		59,292.50
Total		$168,318.20

Cash receipts and payments were compiled as follows:

Receipts	
Accounts receivable	$101,206.30
Notes payable	29,483.00
Payments	
Notes payable	$ 1,050.00
Accounts payable	46,785.40
Machinery and equipment	2,500.00
Manufacturing costs	85,416.75
Selling expenses	9,843.60
Administrative expenses	15,194.15

As of April 15, 1937, accounts receivable were $169,896.25; accounts payable were $30,105.60.

Depreciation to April 15, to be considered: machinery and equipment, $1,571.50; automobiles, $805.35.

Merchandise inventory saved from the fire was given a value of $18,500.

The inventory was insured for $29,000 on an 80 per cent co-insurance policy. The insurance company agreed to accept a before-the-fire inventory calculated on an average gross profit basis of 38 per cent.

Machinery and equipment fire loss was $4,500. On this, the insurance company agreed to pay 90 per cent.

Problem 206

(Ohio, November, 1931)

The balance-sheet of The Ohio Manufacturing Company disclosed the following financial condition as of December 31, 1930.

Assets		*Liabilities*	
Cash	$ 10,000	Notes payable	$ 20,000
Accounts receivable	50,000	Accounts payable	60,000
Inventory	85,000	Bonded debt	20,000
Investments	40,000	Reserve for depreciation:	
Land	12,000	Buildings	8,000
Buildings	20,000	Machinery	10,000
Machinery	15,000	Automobiles	3,000
Automobiles—sales department	5,000	Furniture and fixtures	1,500
Furniture and fixtures—office	3,000	Capital stock	100,000
Prepaid fire insurance	1,000	Surplus	18,500
Total	$241,000	Total	$241,000

Depreciation rates used by the company are as follows:

On buildings	3%
On machinery	6%
On automobiles	20%
On furniture and fixtures	8%

By applying these rates, the book value of depreciable property has reflected its actual value at all times.

The following transactions were recorded on the company's books during the period from January 1, 1931, to March 31, 1931:

Sales invoiced	$26,250
Purchases (usual credit terms)	20,000
Cash collections on accounts receivable	40,000
Payments on accounts payable	30,000
Bonds retired at par	5,000
Payments for:	
Labor	2,000
Sundry manufacturing expense	3,000
Administrative and selling expenses	2,000

Real estate taxes for the calendar year 1930 amounted to $1,000, and personal property taxes for the same period amounted to $2,000, all having been paid in that year; however, no amount has been accrued on the books for 1931. The prepaid fire insurance represents the unexpired portion of expense for the year ended June 30, 1931.

Obsolete items, which for the purpose of this problem can be assumed to be valueless, were erroneously included in the inventory at December 31, 1930, at the cost thereof, amounting to 6⅔ per cent of the recorded cost of goods sold. The past experience of the company has shown that approximately that percentage of merchandise becomes obsolete each year, but no provision for such loss has been made on the books since January 1, 1930.

The company sold and received payment for a lot of merchandise on March 31, 1931, a transaction not recorded on the books, at a special price representing an advance of two-fifths over cost shown by the books, less a 10 per cent discount, on which basis the gross profit was $2,730.

The gross profit for 1930, as shown by the company's books, amounted to $30,000, which was 40 per cent of the cost of goods sold.

On the night of March 31, 1931, a fire occurred in the company's plant which destroyed 50 per cent of the buildings, machinery and inventory. Automobiles, furniture and fixtures were removed without loss.

The company carried $8,295 insurance on buildings, $4,500 on machinery and an amount on merchandise equal to 80 per cent of the inventory at March 31, 1931—all on an 80 per cent co-insurance basis. No coverage was carried on automobiles and furniture and fixtures. Because of the fire one-half of the insurance was canceled as of April 1, 1931.

Required of candidates:

From the foregoing, prepare a balance-sheet as of March 31, 1931, giving effect to the insurance claim for fire loss and statements of income and expense and surplus for the three months period. Also submit journal entries to adjust the company's books and an exhibit showing clearly how you determined the amount of insurance claim. The liability for income taxes, if any, may be disregarded.

Problem 207

(Ohio, November, 1934)

You have been retained by a fire insurance adjuster to examine the records salvaged from a fire which almost completely destroyed the office and warehouse of X, Y and Z, partners in a wholesale jobbing business.

Your report, direct to the adjuster, must include an estimate of the inventory value as of the date of the fire, January 3, 1933, and a detailed statement of your examination and its results.

The merchandise handled by the firm is divided into four lines or classes of goods, designated as A, B, C and D. Classes A, B and C each consist of a number of items that are bought and sold without change of form; Class D consists of one item only for which raw material is bought and put through a manufacturing process.

The following records are found to be available:

Duplicate sales invoices and credit memoranda, the totals of which are as follows:

	Sales	Credit memoranda
Year 1930	$122,785	$6,585
Year 1931	110,942	7,582
Year 1932	87,000	3,520

A check of the numbers discloses that approximately 10 per cent of the duplicate sales invoices for 1932 are missing, and your report should include a comment as to the possible effect of this fact upon the inventory at the time of the fire.

Duplicate bank deposit slips without any missing dates:

Year 1930	$108,066
Year 1931	96,008
Year 1932	91,150

Purchase invoice files, accompanied by adding machine tapes purporting to show the total purchases for each year, with totals as follows:

Year 1930	$131,616
Year 1931	117,935
Year 1932	76,158

Inventory sheets as taken by the management as of January 1, 1930:

Class A	$42,120
Class B	19,890
Class C	24,570
Class D—raw materials	17,550
—finished, four-sevenths of which is raw material	16,380
"Books trading stamps"	5,840

The management stated that about 17 per cent was added to cost of merchandise and raw materials to cover freight, handling and overhead, and a comparison of some of the inventory prices with purchase invoices at about the date of the inventory approximately confirmed this statement. You find, however, that 2 per cent of net purchases is sufficient to cover freight and handling into the warehouse and allow this percentage in all cost computations. You ascertain also that 17 per cent has been added to the cost of direct labor and overhead in the finished goods inventory and that the overhead is 50 per cent of direct labor.

Duplicate bank-deposit slips were found to represent receipts from accounts receivable and cash sales only. You learn on inquiry that the partnership has made a practice of paying some expenses out of cash receipts not deposited. The amount of such payments cannot be determined.

Upon examination of the contents of the purchase invoice files you find that credit memoranda representing allowances on purchases have been listed on the adding machine tapes as invoices and included in the totals, as follows:

Year 1930	$7,548
Year 1931	7,225
Year 1932	6,120

All suppliers of merchandise and materials are circularized with a request for an itemized statement of account for the last

three years, and their statements show additional credit memoranda to the following amounts:

Year 1930	$1,751
Year 1931	3,128
Year 1932	5,610

Raw materials for Class D are purchased in carload lots, and the invoices for the three years show total purchases of $33,000. You find that the shop foreman has kept a record showing that raw materials, of which the invoice cost was $34,000, have been put in process in the three years and that the proportions of direct labor and overhead to material cost have been approximately maintained.

There have been no purchases of trading stamps during the three years.

Analysis of a considerable number of sales invoices selected in such a way as to give a fair sample of the entire file, and tracing the cost price of each item, give results that are summarized as follows:

	Per cent of net sales	Per cent gross profit to net sales
Class A	37	11
Class B	18	18
Class C	21	20
Class D	23	32
"Books trading stamps"	1	0

You are to prepare:

Computation of approximate inventory January 3, 1933, including a schedule showing separately the raw materials and finished goods in Class D.

Report to fire insurance adjuster outlining the details of your examination and explaining your method of estimating the inventory.

Do not carry out any computations farther than the nearest dollar.

Problem 208

(American Institute of Accountants, May, 1936)

The plant of the Tamarack Manufacturing Company, engaged in the manufacture of hunting and camping articles, was partly destroyed by fire on the night of September 1, 1935. Practically all books of account were burned, but the data given below were obtained from various sources.

Balance-sheet January 1, 1935

Assets		*Liabilities*	
Machinery and fixtures	$ 47,000.00	Notes payable	$ 4,729.50
Automobiles	3,494.40	Accounts payable	2,553.60
Liberty bonds	10,000.00	Reserve for depreciation	8,437.50
Customers' accounts	35,524.00	Capital stock	100,000.00
Inventory	50,000.00	Surplus	59,220.90
Cash	28,923.10		
Total	$174,941.50	Total	$174,941.50

An analysis of the cheque book and cancelled vouchers revealed the following receipts and payments:

Receipts		*Payments*	
From customers	$ 98,746.70	Notes payable	$ 917.50
Notes payable	34,376.00	Accounts payable	42,584.20
Interest on bonds	237.50	Machinery	3,750.00
		Labor	77,366.40
		Administrative salaries	9,675 28
		Selling expenses	11,900.00
		Sundry manufacturing expenses	646.62
		Rent	4,000.00
		Office expenses	2,418.50
		General expenses	2,381.40
Total	$133,360.20	Total	$155,639.90

A report rendered to the president on September 1, 1935, showed that $172,952.10 was receivable from customers and $24,457.50 was due to creditors (acounts payable).

There should be a charge of $1,012.50 for depreciation to September 1, 1935, and the automobiles should be written down to $3,000.

An inventory of the merchandise not burned was valued at $20,000. The insurance company agreed to accept the inventory of the company as before the fire if calculated on a basis of

average gross profits at 35% of the sales. The company's inventory was insured for $30,000 on an 80% co-insurance policy. There was a $5,000 loss on machinery and fixtures which the insurance company also agreed to pay.

From the foregoing data:

(a) Reconstruct the accounts of the company, and show the method followed.

(b) Prepare (1) a balance-sheet as at September 1, 1935, which is to include the liability of the insurance company and (2) a profit-and-loss account for the eight months ended on that date, showing details of cost of sales.

Problem 209

(Pennsylvania, November, 1931)

From the following trial balance of an old-line life insurance company, prepare for submission to the commissioner of insurance a statement of financial condition, using your own figures on any prepaid or accrued items. The reserve on insurance in force has been calculated in the amount of $5,701,675.

INDEFATIGABLE LIFE INSURANCE COMPANY
Trial balance, December 31, 1930

Advances to agents	$ 21,757 79	
Advertising	5,101.48	
Bills receivable—first year	25,469 93	
Borrowed money		$ 50,000 00
Books—newspapers and periodicals	1,525 56	
Bureau and associations dues, etc	1,186 94	
Capital stock		560,000.00
Cash in banks	161,490.30	
Cash and checks in offices of company	12,041.89	
Commissions	140,911.72	
Commuted renewal commissions	500.00	
Death losses	284,692.00	
Directors' fees	2,540.00	
Disability annuity payments	225.00	
Depreciation of furniture and fixtures	2,364.65	
Employees' salaries	38,378.16	
General expense	9,826.27	
Investigation of death claims	541.73	
Furniture and fixtures	11,547 92	

INDEFATIGABLE LIFE INSURANCE COMPANY.—(*Continued*)

Inspection of risks	$ 1,839.67	
Insurance department fees	1,912.17	
Interest received—bond fund		$ 4,580.59
Interest received—bonds		78,188.64
Interest received—mortgages		204,114.21
Interest received—notes and liens		59,111.13
Interest paid on borrowed money	1,486.44	
Investments:		
Bonds as amortized	1,335,741.83	
First mortgages	3,641,387.00	
Stocks at market	178,875.00	
Real estate (home office)	154,495.21	
Investment expense	3,289.09	
Matured endowments	23,605.00	
Medical examinations	7,201.22	
Officers' salaries	36,708.73	
Policy dividends paid in cash	94,528.79	
Policy loans	1,145,834.86	
Postage	5,800.54	
Premiums received—first year		145,931.16
Premiums received—renewal		1,048,795.07
Premium lien notes	24,327 85	
Printing and stationery	5,099 88	
Reinsurance commissions—first year		28,220.59
Reinsurance commissions—renewals		9,037.23
Credit balances due agents		1,451.23
Reinsurance policy dividends		12,585 21
Reinsurance premiums—first year	52,360.21	
Reinsurance premiums—renewals	165,675.49	
Repairs and expense—real estate	5,870 56	
State tax on premiums	4,824.00	
Surrender values paid	267,149.12	
Surrender value applied to purchase paid up insurance	23,466.54	
Taxes on capital stock	7,607.31	
Taxes on real estate	2,758.49	
Traveling expenses	5,003.49	
Ledger surplus		5,714,934.77
Total	$7,916,949 83	$7,916,949.83

In the audit of an old-line life insurance company:

1. What steps should you take to verify the reserve on insurance in force as presented to you by the actuarial department of the company, calculated as per the American experience table of mortality at 3½ per cent interest?

2. Having found the paid death claims properly supported by the required documents, what further action should you take to satisfy yourself that the proper disbursements had been made?
3. Explain the distinction between policy loan notes and premium lien notes.

SECTION XXIII

REAL ESTATE, CONTRACTORS' ACCOUNTS

Problem 210

(Ohio, May, 1933)

The Memorial Park Land Company was organized to acquire and develop a tract of land for cemetery purposes. A suitable property was purchased for $50,000, and engineers were employed to make the necessary plans and supervise improvements which were estimated to cost as follows:

Engineering and planning	$ 7,500
Clearing and grading	36,000
Roads, bridges, etc	15,000
Water and drainage	13,000
Trees and shrubbery	6,000

The property has been laid out in 4,000 lots, and these are divided into three sections according to size, location and relative value, viz.:

Block A	1,000 lots	Retail value	$250 each
Block B	1,000 lots	Retail value	200 each
Block C	2,000 lots	Retail value	150 each

The Memorial Park Sales Company has been organized to market the property. Ninety per cent of its capital stock is owned by the Land Company, and 10 per cent has been issued to the manager of the Sales Company.

The Sales Company will sell all lots at retail but with the understanding clearly indicated in each contract that 15 per cent of the selling price, or retail value, does not represent a consideration for the lot itself but is a special contribution to a perpetual property-maintenance fund, and the Sales Company agrees with reasonable promptness to pay to an independent trustee out of the initial receipts from each sale an amount equal to 15 per cent of the retail value. Neither the Land Company nor the Sales

Company will have custody or control over such funds after they are paid to the trustee.

The Sales Company in every case will collect an initial payment of 25 per cent of the retail value of lots sold and agrees to pay its salesmen a commission of 25 per cent of the full retail value, but such commission shall be paid only in proportion to annual collections of the retail value. Although this commission is computed on full retail value which includes the maintenance fund, this method of computation was adopted for convenience only. The commission is for the sale of lots and is equal to more than 25 per cent of the consideration received for land alone.

The development of the property was incomplete at December 31, 1932; nevertheless the Sales Company has made the following sales and collected only the prescribed initial payments. The purchase price payable by the Sales Company to the Land Company is also shown:

Block A....	200 lots payable to Land Company	$110.50 each
Block B....	250 lots payable to Land Company	88.40 each
Block C....	600 lots payable to Land Company	66.30 each

It will be noted that the Sales Company is charged with lots only as sales are made and carries no inventory of unsold lots.

In connection with the following trial balances, you are advised—

1. The Land Company has not included in accounts payable certain invoices unpaid at December 31, 1932, for clearing and grading $2,500; and for roads, bridges, etc., $3,000.
2. The item of notes payable of $30,000 is found upon verification to include $10,000 which was not a note of the Land Company but a note payable of the Sales Company to the Land Company. This note had been discounted by the Land Company, and the funds used for developing its property.

THE MEMORIAL PARK LAND COMPANY
Trial balance December 31, 1932

Land	$ 50,000
Engineering and planning	6,000
Accounts receivable: Sales Company	104,605
Investment Sales Company	9,000
Clearing and grading	31,500

THE MEMORIAL PARK LAND COMPANY.—(*Continued*)

Roads, bridges, etc	$ 6,000	
Water and drainage	2,000	
Cash	7,375	
Expenses, interest, taxes, etc	14,000	
Trees and shrubbery	1,500	
Accounts payable		$ 18,000
Notes payable		30,000
Sales of lots		83,980
Capital stock		100,000
Totals	$231,980	$231,980

THE MEMORIAL PARK SALES COMPANY
Trial balance December 31, 1932

Cash	$ 6,495	
Cash paid to trustee	20,000	
Payments to salesmen	26,875	
Sales office equipment	14,400	
Depreciation	1,600	
Due from sales manager on stock subscription	500	
Cost of lots sold	83,980	
Expenses, interest, taxes, etc	8,255	
Accounts payable—Land company		$104,605
Capital stock		10,000
Sales receipts		47,500
Totals	$162,105	$162,105

You are requested to prepare on the instalment-sales basis consolidated balance-sheet and income and expense statement. These should be in a columnar form and prepared in ink but need not include provision for federal taxes.

Problem 211

(American Institute of Accountants, November, 1936)

A. Arthurs, a real-estate dealer, owned and operated the following buildings:

Stratford Terrace—an apartment house acquired March 1, 1929, at a cost of $350,000 and mortgaged as follows:

First mortgage, dated February 1, 1933, due February 1, 1938, interest payable February 1st and August 1st at 5% per annum	$200,000
Second mortgage, dated April 1, 1933, due April 1, 1938, interest payable April 1st and October 1st at 6% per annum	90,000

Munroe Building—an office building acquired April 1, 1931, at a cost of $1,500,000, mortgaged as follows:

First mortgage, dated February 1, 1930, due February 1, 1940, interest payable February 1st and August 1st at 5% per annum	$750,000
Second mortgage, dated May 1, 1934, due May 1, 1937, interest payable May 1st and November 1st at 6% per annum.......	450,000

The four mortgages were to be reduced by regular instalments, but nothing had been paid off by Arthurs, and on March 1, 1935, the holders formed a committee to operate the two buildings from that date. John Smith was appointed agent and no charge was to be made for his or the committee's services.

Arthurs was to receive 5% of all rents collected after deducting operating expenses, taxes and interest, and he was to pay $100 a month as rent for office space occupied in the Munroe Building. Any balance remaining at the end of the fiscal year was to be applied pro rata by the agent to reduce the second mortgages.

The holders of the mortgages agreed to accept monthly instalments of the year's interest and taxes and in turn to advance, if required, the money for taxes when due. The 1935 taxes were:

Stratford Terrace..............................	$ 5,160
Munroe Building..............................	28,000

Depreciation was to be provided at the annual rates of 2% on buildings and 10% on furniture and fixtures, as in previous years.

Arthurs continued to keep the general books, and the agent rendered to him monthly statements of rents billed and collected, operating expenses, taxes, interest and other payments. However, only the cash received from the agent was entered and no record was made of these statements.

The following is a summary of the transactions thus reported covering the operations in the ten months March to December, 1935:

	Stratford Terrace	Munroe Building
Rents billed..............................	$128,500.00	$230,000.00
Rents collected..............................	$124,070.00	$228,000.00
Operating expenses paid..............................	$ 58,000.00	$ 99,810.00
Interest paid—		
First mortgage..............................	10,000.00	27,500.00
Second "	5,400.00	27,000 00
Taxes paid..............................	5,160.00	28,000.00
Totals..............................	$ 78,560.00	$182,310.00
Balance of receipts..............................	$ 45,510.00	$ 45,690.00
5% paid to A. Arthurs..............................	$ 2,275.50	$ 2,284.50

Since December 31, 1934, none of the unamortized mortgage expenses had been written off, nor had provision been made for accruing mortgage interest and depreciation, but all ascertainable direct current liabilities outstanding at December 31, 1935, had been taken up, and the following trial balance was prepared as of the latter date:

	Debits	Credits
Stratford Terrace:		
Land	$ 50,000	
Building	300,000	
First mortgage		$ 200,000
Second "		90,000
Unamortized expenses—first mortgage	11,100	
" " —second "	9,945	
Reserve for depreciation		35,000
Rents receivable	12,530	
Munroe Building:		
Land	300,000	
Building	1,200,000	
First mortgage		750,000
Second "		450,000
Unamortized expenses—first mortgage	53,375	
" " —second "	28,000	
Reserve for depreciation		90,000
Rents receivable	24,600	
Office furniture	1,360	
" " reserve for depreciation		630
Investments—stocks and bonds	117,500	
Cash	1,686	
Notes receivable	15,400	
Notes payable		16,500
Insurance premiums receivable	3,000	
Prudence Life Assurance Co		1,250
Kentucky Fire Insurance Co		1,150
Jameson Realty Co		4,740
Rent security deposits		3,000
John Smith—agent		4,560
A. Arthurs—personal account	22,551	
" " —capital "		502,551
Stratford Terrace:		
Rent income		11,200
Operating expenses	102	
Munroe Building:		
Rent income		28,750
Operating expenses	245	
Interest—first mortgage	10,000	
Commission on insurance premiums		350

	Debits	Credits
Interest received on bonds		$ 1,789
Dividends received on stocks		2,330
Interest on notes received and payable—net		21
Salaries paid	$ 25,412	
Legal expenses	2,600	
Office rent	1,000	
Office expenses	2,465	
Uncollectible rents written off	950	
Totals	$2,193,821	$2,193,821

Prepare adjusting entries, working trial balance and balance-sheet as at December 31, 1935, and a relative income statement for the year.

Problem 212

(Ohio, May, 1930)

The directors of the Real Construction Company have requested a statement of the real estate construction operations separate from all other departments of the company for the year 1928. They have organized a new corporation for the purpose of operating a real estate construction business, and the transfer of assets and liabilities is to be made, excluding any cash, as of January 1, 1929.

Trial balance of the real estate construction department as of January 1, 1928, was determined to be as follows:

Mortgages receivable	$21,800	
Instalment sales contracts	48,400	
Real estate—land	51,300	
Real estate—finished construction	54,600	
Real estate—construction in process	13,200	
Construction equipment	4,950	
Accounts payable		$22,420
Mortgages payable		72,500
Reserve for depreciation:		
Real estate construction		6,740
Construction equipment		1,850
Discount on mortgages		1,620
Unrealized profit on instalment sales		6,050

The records show that during the year construction in process was completed with $2,400 for lumber, roofing, etc., and $2,800

for subcontracts. New construction completed cost $34,000 for lumber, roofing, etc., and $78,000 for subcontracts.

Construction sales were as follows:

	Five houses built 1927	Eight houses built 1928
Sale price (each)	$7,000	$ 8,500
Mortgage payable (each)	3,500	4,000
Cost of land (each)	800	1,000
Cost of construction (each)	4,800	5,500

Payments received during the year on these sales were found to be 25 per cent on two of the houses built in 1927, 20 per cent on four of the houses built in 1928 and 50 per cent on all other sales. Rents received on houses rented pending sales were found to be credited correctly to rent income account. Other payments included in receipts were: $12,000 on instalment sales contracts, the realized profit being $1,500; on mortgages receivable $4,800 and on mortgages payable for new construction $72,000.

Liabilities of the real estate construction department at January 1, 1929, for accounts payable were $38,800.

You are to provide depreciation as follows:

Real estate construction	5%
Construction equipment	10%
Plant buildings	5%
Plant equipment	10%
Automobile equipment	25%

Provide 50 per cent of these rates where information shows that the assets were acquired or completed during the year.

Adjustment for prepaid items and accruals have been recorded. Closing inventory of lumber, roofing, etc., was $54,800.

Trial balance of the books at December 31, 1928, was as follows:

Cash	$ 7,850
Accounts receivable	51,800
Notes receivable	16,600
Mortgages receivable	17,000
Instalment sales contracts	101,600
Inventory—lumber, roofing, etc., January 1, 1928	78,420
Real estate—land	51,300
Real estate—finished construction	171,800
Real estate—construction in process	13,200

Securities owned	$ 5,000	
Plant—land	18,480	
Plant—buildings	47,500	
Plant—equipment	18,300	
Plant—automobile equipment	22,400	
Construction equipment	7,050	
Prepaid accounts	1,790	
Accounts payable		$ 59,700
Notes payable		31,200
Mortgages payable		95,000
Accrued accounts		11,420
Reserve for doubtful accounts		6,500
Reserve for depreciation:		
Plant—buildings		8,500
Plant—equipment		3,850
Plant—automobile equipment (selling)		9,800
Construction equipment		1,850
Real estate construction		6,740
Discount on mortgages		820
Unrealized profit on instalment sales		6,050
Capital stock		150,000
Earned surplus		43,340
Sales—lumber, roofing, etc		463,900
Sales—real estate construction		103,000
Sales—miscellaneous yard		12,800
Purchases—lumber, roofing, etc	256,300	
Purchases—miscellaneous yard	6,340	
Overhead expense—Plant	88,800	
Expense control—real estate construction (including interest)	7,400	
Selling expense	14,800	
Administrative expense	12,820	
Interest expense	8,500	
Interest income		2,380
Rent income—real estate construction		8,200
Total	$1,025,050	$1,025,050

Disregard cents in your calculation, and round out to the nearest dollar

Prepare:

Statement of profit and loss of real estate construction department for year 1928.

Journal entries to transfer assets and liabilities of real estate construction department to new company, using 5,000 shares of no-par stock.

Balance-sheet of Real Construction Company at January 1, 1929 (after the transfer), including as a liability the federal income tax reported upon the instalment sales basis.

Problem 213

(Wisconsin, November, 1932)

The Bargain Contracting Company of Waupun, Wisconsin, does a general contracting business under both cost-plus and flat-sum contracts. A trial balance of the books on December 31, 1931, is as follows:

Cash	$ 134,524	
Accounts receivable	148,317	
Reserve for bad debts		$ 6,912
Contracts in progress, January 1, 1931	187,473	
Deposits on bids	22,500	
Materials inventory	28,309	
Land	24,000	
Building	18,500	
Reserve for depreciation		1,665
Machinery and equipment	43,100	
Reserve for depreciation		19,395
Automobile trucks	11,600	
Reserve for depreciation		3,700
Construction payroll	185,248	
Materials purchases	203,766	
Construction supplies and expense	42,354	
Engineering and drafting department expense	31,376	
Yard expense	2,893	
Salaries—administrative	26,412	
Telephone and telegraph	637	
Taxes	3,900	
Insurance	4,715	
Accounts payable		37,185
Notes payable		90,000
Capital stock		150,000
Surplus		133,301
Amount requisitioned		684,618
Automobile supplies and expense	2,964	
General expense, interest, etc.	4,188	
Totals	$1,126,776	$1,126,776

Notations:

Reserve an additional $3,500 for bad debts		
Depreciation for the year:		
Building	3%	
Machinery and equipment	15%	
Automobile trucks	25%	
Unexpired insurance		$ 933
Materials inventory		31,692
Construction supplies inventory		1,783
Accrued construction payroll		1,292
Accrued taxes		200
Accrued interest payable		480
Accrued office salaries		896
Bonus due engineering and drafting departments		725

It is agreed that in addition to the direct charges to construction for material, labor, and supplies, contract costs are to include 80 per cent of the engineering and drafting department expense, all of the yard expense, 60 per cent of the administrative salaries, 70 per cent of the taxes, insurance and depreciation on building, all of the depreciation on the machinery and equipment and 90 per cent of the automobile supplies and expenses, including depreciation on trucks.

Investigation discloses that included in the amount requisitioned there are completed contracts amounting to $497,810, which cost $396,512. In addition there are uncompleted cost-plus 10 per cent contracts totaling $70,400.

Invoices totaling $51,300 were sent to customers based on the architect's certificates authorizing an additional amount to be requisitioned. This item has not yet been recorded on the books.

The policy of the corporation is to take profits on flat-sum contracts only upon completion.

From the foregoing prepare a working sheet, showing:

1. Cost of contract sales.
2. Net profit for 1931.
3. Balance-sheet.

Problem 214

(Ohio, May, 1935)

The Columbus Construction Company, incorporated February 1, 1934, started business with $100,000 paid in for 20,000 shares

(par value $1 a share) of which $2,000 was paid for incorporation expense.

It borrowed $250,000 on March 1 for one year at 5 per cent discount and pledged as security 2,500 shares of American Telephone & Telegraph common stock owned by the president and principal shareholder.

During the period ended December 31, 1934, the company expended the following amounts for general and administrative items which, in whole or in part, are charged to construction projects as "overhead."

Executive salaries	$20,000
Office salaries and expenses	18,000
State and local taxes	3,300
Engineering and planning	16,000
General expense	7,500

Unpaid bills at December 31 included the following:

Taxes accrued	$ 400
Engineering salaries accrued	2,000

The company carried no workmen's compensation insurance but maintained a separate bank account into which was deposited a fixed portion of its payrolls (exclusive of labor payments during guaranty period) and against which were charged payments made pursuant to awards by governmental authority. The company was compelled to furnish a surety bond to the state in the amount of $100,000 which was purchased March 1 at a cost of $1,500 per annum.

The company guarantees its work for a period of six months following completion of contracts. The experience of similar businesses is that additional costs during such period amount to 5 per cent of the labor cost of the job. The company desires that you will, in preparing your schedules, establish a reserve account to take care of this condition with such detail as will permit the reserve balance on each contract to be closed out when the guaranty period expires.

The construction projects undertaken during the year 1934 and the history of each are set forth below:

Project 1. *Apartment house.* Contract $200,000, extras $12,000. Completed June 15, 1934. Expended—materials $90,000, labor $50,000, self-insurance charge $1,250, overhead charge

$8,000. $15,000 new equipment charged to job of which $12,000 was credited upon completion. Contract price paid upon completion except 10 per cent withheld during guaranty period and then paid. Additional costs of $900 were incurred and paid after completion of project but during the guaranty period.

Project 2. *Office building.* Contract $350,000. Completed August 20, 1934. Materials $200,000, labor $80,000, self-insurance charge $2,000, overhead charge $12,800. $20,000 new equipment charged to job and $14,000 credited upon completion. $300,000 of contract price paid, balance withheld claiming inferior work. Suit instituted December 1 for balance plus 6 per cent interest. Additional costs of $4,100 incurred and paid in November, during guaranty period.

Project 3. *Warehouse.* Contract $500,000. Incomplete. Material, including $10,000 transferred from project 4, amounted to $298,000 and was all on the job, although $40,000 was unpaid at December 31; other costs were: labor, $140,000, this being 70 per cent of total estimate; overhead charge, $22,400; self-insurance charge, $3,500. New equipment charged to job $25,000, estimated depreciation to December 31, $5,600. 60 per cent of contract price billed on architect's releases of which $250,000 has been paid. Two workmen injured on November 1, one awarded $600 cash, paid on December 20; and the other $100 a month for four months from November 1, no part of which had been paid at December 31.

Project 4. *Hotel.* Contract $600,000. 70 per cent completed. Work discontinued November 1. Owner insolvent. Lien filed for unpaid estimates of $80,000. First-mortgage bonds of $350,000 issued by owner prior to this contract exceed value of property. $130,000 of the proceeds from the bonds had been used to purchase the hotel site. Material, $275,000; labor, $100,000; self-insurance charge, $2,500; overhead charge, $16,000. Used equipment in the amount of $20,000 was charged to job and removed November 1 at value of $16,000. 50 per cent of contract billed and $220,000 paid in cash. Out of these receipts, $6,100 was invested in $6,000 U. S. Treasury Bonds at par and accrued interest for self-insurance fund. Semi-annual interest coupon of $127.50 deposited December 15. A workman injured on October 15 awarded $1,000 cash which was paid December 1 and $50 monthly for six months from October 15, no payments

being in arrears at December 31. Unused materials costing $10,000 have been transferred to project 3, but the transfer was not entered on records of project 4. Outstanding firm contracts for undelivered material aggregate $60,000 at December 31. Estimated salvage value of such material is $35,000.

Promotional work had been done, and plans were drawn for other projects not reduced to contracts at December 31.

Prepare such financial statement and schedules as would be expected of a C.P.A. employed to furnish the management with a comprehensive view of its operations and financial condition at December 31, 1934.

SECTION XXIV

VALUATION OF FIXED ASSETS

Problem 215

(New York, October, 1936)

The X Manufacturing Company purchased a plot of land for $22,000 as a plant site. There was a small building on the plot, conservatively appraised at $4,000. The company had plans drawn for a factory and received contractors' bids therefor. It rejected all bids and decided to construct the plant itself. Land account was charged with the purchase price of $22,000, and building account was charged with the following items:

Materials, net after discounts:	
Cement block, bricks and tile	$38,592.32
Cement, sand, gravel, etc.	18,339.45
Lumber, sash and plumbing	35,711.91
Other materials and supplies	22,532 78
Cellar excavation	7,500.00
Labor on construction	63,546 98
Cost of remodeling old building into office building	3,500.00
Interest on borrowed money	1,750.00
Interest on own money used	5,250 00
Cash discounts on materials used	2,800 00
Supervision by management	4,000.00
Compensation insurance premiums	3,000.00
Payment of claim for injuries not covered by insurance	750.00
Clerical and other expenses of construction	3,000.00
Paving of streets and sidewalk	3,100.00
Architect's plans and specifications	850.00
Legal expenses of conveying land	450.00
Legal expenses of injury claim	400 00
Profits credited to profit and loss account, being the difference between the foregoing cost and the lowest contractor's bid	5,923.56

Prepare work sheet and statements of the fixed asset accounts showing in detail the items to be included in each account.

Problem 216

(District of Columbia, May, 1933)

The Bertram Fixtures Corporation on October 1, 1929, purchased on contract a tract of vacant land adjoining its plant for $50,000, payable $10,000 in cash and $5,000 each year thereafter on October 1, with interest at 6 per cent. The unpaid balance was secured by a first mortgage. Unpaid special assessments totalling $1,575 were assumed. General taxes for 1929 were to be prorated.

On July 1, 1932, the board of directors, desiring to free itself of the burdensome contract and seeing no need for the land for some time to come, authorized the president to cancel the contract. On this date the books showed the following:

Vacant land—		
October 1, 1929	Original cost, including unpaid special assessments	$51,575.00
May 2, 1932	Special assessment for street-lighting system	1,200 00
	General taxes for period from October 1, 1929, to June 30, 1932, paid or accrued	3,312.16
	Interest on unpaid balance from October 1, 1929, to June 30, 1932, paid or accrued	5,850 00
June 30, 1932	Total book value	$61,937.16
Liabilities at June 30, 1932—		
	Purchase money mortgage	$30,000.00
	Accrued interest to June 30, 1932	1,350.00
	General taxes accrued to June 30, 1932	600.00
	Unpaid special assessments	2,175.00
June 30, 1932	Total liabilities	$34,125 00

The vendor agreed to cancel the present contract and interest accrued thereon, assume unpaid taxes and assessments and give the company an option to repurchase for $35,000 on or before five years after July 1, 1932, upon the payment by the Bertram Corporation of $2,500. The president accepted the offer and paid the $2,500 on July 8, 1932.

On July 1, 1932, the property was appraised at $25,000.

Make the necessary entries as at July 1, 1932, to record this transaction. Give your comments.

Problem 217

(District of Columbia, May, 1930)

In connection with the audit of the Y Corporation, you find an account called land and buildings, which has been charged with the following:

Date	Particulars	Amount
February 1, 1929	Attorneys' fees in connection with organization of the company	$ 1,000.00
February 6, 1929	Cost of land and old building	112,400 00
February 28, 1929	Discount on sale of stock	15,000.00
February 28, 1929	Miscellaneous organization expenses	518.12
February 28, 1929	Cost of razing old building	2,546.00
March 17, 1929	Attorneys' fees and expenses in connection with the purchase of land and old building	2,000.00
March 31, 1929	Stock bonus given to promoters; 150 shares of preferred stock—par value $100 each	15,000 00
March 31, 1929	Administrative and general expenses, February and March	6,318.13
April 15, 1929	Total cost of new building erected	96,318.63
April 15, 1929	Discount and expense on bonds	5,000.00
May 6, 1929	Real estate taxes	1,850.33
May 31, 1929	Administrative and general expenses, April and May	14,419.64
October 15, 1929	Interest on bond issue	3,250.00
Total per books		$275,620.85

You also find that:

1. The Y Corporation was organized January 2, 1929.
2. The bond issue was for the purpose of paying for the cost of the building, is dated April 15, 1929, bears 6½ per cent interest and is payable semi-annually.
3. Real estate taxes of $1,850.33 were deducted from the purchase price of $112,400 and were credited to organization expenses at February 6, 1929.
4. On February 28, 1929, the balance of $518.12 in the organization expense account was charged to land and buildings.
5. The normal operations of the business began July 1, 1929.
6. Administrative and general expenses consisted of:

Officers' salaries	$16,000.00
Factory superintendent's salary	3,000.00
Supplies, light, heat, etc	1,737.77
Total	$20,737.77

7. Aside from reviewing the plans, blueprints, etc., neither the officers nor the factory superintendent were connected with the construction of the new building.

In order that depreciation may be properly computed, you are to set up separate accounts for land and buildings, stating your reasons supporting the various kinds of items that you include in each account.

In case certain charges found in land and buildings are not, in your opinion, properly chargeable to either land or buildings, state what disposition you would make of them.

Problem 218

(New York, April, 1933)

In auditing the books of the Ajax Manufacturing Company for the year ended December 31, 1932, you find it necessary to make adjustments in the accounts.

Machinery and tools have been carried in one account termed plant machinery. On January 1, 1932, the balance in this account was $694,250. Of this amount $620,150 represented the cost value of the machinery, and $74,100 the cost value of the tools. Both assets were purchased March 15, 1931. At the end of the year 1931, depreciation of $70,500 was set up in the accounts; at the end of the year 1932, $80,300 was provided for depreciation.

It is now decided to adjust the depreciation so as to provide depreciation reserves at the rate of 12½ per cent per annum for machinery and 20 per cent per annum for tools; it is also decided to separate the respective asset and reserve accounts on the books.

During the year 1932 the following additions were made to these assets:

Machinery purchased	
March 15, 1932	$38,750
October 1, 1932	75,125
Tools purchased	
August 1, 1932	19,750
November 15, 1932	14,375

At December 31, 1932, the balances shown on the books are as follows:

Plant machinery	$842,250
Reserve for depreciation	150,800

Prepare abstracts of new accounts and the journal entries to be placed on the books, assuming that the accounts have been closed as of December 31, 1932.

Problem 219

(American Institute of Accountants, May, 1933)

From the following data, revise as of December 31, 1929, the machinery, depreciation reserve, surplus and income accounts for the year 1929, wherever necessary, and prepare a schedule showing loss or gain on dismantlements. State what you would advise your client to do with regard to federal taxes, giving your reasons for such advice.

The S Novelty Company was organized January 1, 1926, to take over the business (including the machinery) of three other companies. Capital stock of $1,500,000, in shares of $100 par value each, was issued, $750,000 for cash and $750,000 for the appraised value of the machinery of the three companies which were consolidated to form the S Novelty Company. No stock was issued except for cash or the machinery of the constituent companies, working capital being provided from the proceeds of the sale of stock.

The company's operations were carried on in a rented building. The annual profits and losses of the company from 1926 to 1931, as shown by the books and as returned for federal income taxes, were:

Year	Loss	Profit
1926	$100,000	
1927	90,000	
1928	10,000	
1929		$200,000
1930		220,000
1931		180,000

On February 28, 1932, after the books of the company had been closed for the year 1931, an internal-revenue agent visited the office to examine the records regarding the federal-income-tax

return for the year 1929. As the company had shown losses up to the end of 1928, their federal-tax returns had been accepted as rendered. After the agent had been working on the books a few days, he informed the president of the company that an additional federal tax would be demanded for the year 1929, based on an additional income of $54,600, claiming that this increase was due entirely to an adjustment of depreciation. He agreed to the rate of 10 per cent, on plant and machinery and also to the use of the beginning balance in the machinery account as the base for the calculation of depreciation.

You are called upon, at this time, to advise the president of the company as to the proper course to pursue, and you are given an abstract of the machinery account from the ledger, which is as follows:

		Debits	Credits
1926			
Jan. 1	Capital stock (7,500 shares)	$ 750,000	
	Cash	100,000	
	Cash		$ 20,000
	Depreciation		75,000
1927	Cash	150,000	
	Cash		10,000
	Depreciation		83,000
1928	Cash	200,000	
	Cash		50,000
Jan. 1	Appraisal	500,000	
	Depreciation		147,000
1929	Cash	100,000	
	Cash		10,000
	Depreciation		162,000
1930	Cash	50,000	
	Cash		15,000
	Depreciation		171,000
1931	Cash	20,000	
	Cash		5,000
	Depreciation		174,500
Dec. 31	Balance		947,500
	Totals	$1,870,000	$1,870,000

You are shown, also, a copy of the appraisal at January 1, 1926, on the basis of which the stock was issued, and a copy of another appraisal as of January 1, 1928, on the basis of which the charge of $500,000 was made to the machinery account in that year.

The bookkeeper has kept memoranda of the machinery sold or scrapped, as follows:

In the year 1926, machinery included in the appraisal of January 1, 1926, and valued at $30,000, scrapped or sold, realized $20,000, and $500 was spent in tearing it down and preparing it for shipment.

In 1927, machinery appraised at $14,000 as at January 1, 1926, was sold for $9,500 and a stamping machine bought in 1926 for $2,000 was scrapped and sold for $500. The expense of tearing down this machinery and preparing it for shipment was $300.

In 1928, the hydraulic presses, included in the appraisal of January 1, 1926, and valued at $70,000, were sold for $45,000 to make room for more modern equipment. The expense of tearing down and preparing for shipment was $750. These presses were valued at $75,000 in the appraisal of January 1, 1928.

Special machinery bought in 1926 for $10,000, which was appraised at $15,000 on January 1, 1928, was sold during 1928 because the work for which it was purchased was no longer performed by the company. The company received $5,000 from the sale, and $250 was spent in removing the machinery and shipping it to the purchaser.

In 1929, miscellaneous machinery included in the appraisal of January 1, 1926, at $15,000 and in the appraisal of January 1, 1928, at $16,000, was sold for $9,000. Preparation for shipment cost $250.

A special machine, purchased in 1927 for $2,000, was sold in 1929 for $1,000, the purchaser paying all freight and dismantlement charges.

Similar memoranda were kept for the years 1930 and 1931.

NOTE.—The figures subsequent to 1929 are given here merely for information.

Problem 220

(Wisconsin, November, 1937)

John Brown, your junior accountant, has prepared an analysis of the machinery and equipment account of The High Speed Company as shown on the attached work sheet.

From this analysis you are to prepare a *columnar statement* or *schedule* setting forth the following facts:

1. The property account as shown by the books.
2. Your adjustments to the property account.
3. The property account as adjusted.
4. The annual depreciation charges for all of the years covered by the analysis, computed separately for each year's additions. The annual rate of depreciation, on the straight-line method, is 25 per cent. With the exception of the original purchases in 1931, current year's additions are to be depreciated at one-half the normal annual rate. Likewise, assets sold during the year, unless already fully depreciated, are to be depreciated at one-half the normal annual rate.
5. The proper charges to the depreciation reserve.
6. The corrected depreciation reserve as of December 31, 1936, set out by year's additions. Fully depreciated assets are not to be written off.
7. The net adjustments to the depreciation taken on the books for each of the years covered by the analysis.

Prepare a *columnar statement* setting forth the determination of the correct profit realized or loss sustained on the sale or other disposition of all machinery and equipment removed from service.

Work sheet by John Brown:

	Debit	Credit	Balance
1931			
Original purchases, January 2, 1931	$ 8,400		
Additions	6,200		
Depreciation		$3,650	$10,950
1932			
Additions	4,000		
Depreciation		1,500	
Arbitrary write-up to appraisal values determined by the president	6,550		20,000
1933			
Additions	5,300		
Sale of all 1932 additions recorded at selling prices		3,200	
Depreciation		6,000	16,100
1934			
Additions	10,600		
Scrapped machine (one of the original pur-			

	Debit	Credit	Balance
chases) costing $2,400—recorded at amount received from junk dealer		$ 200	
Depreciation		3,000	$23,500
1935			
Additions	$ 1,200		
Repairs to machine acquired in 1933	210		
Depreciation		4,800	20,110
1936			
Additions	4,400		
Scrapped balance of original purchase of machinery and equipment acquired in 1931		8,200	
Depreciation		1,000	
Machine purchased in 1935 at cost of $1,200 transferred to the superintendent as additional compensation at its present value of $500		500	
Damages received as the result of a patent-infringement suit involving a machine patented, owned and used by The High Speed Company		4,000	10,810

Problem 221

(American Institute of Accountants, May, 1934)

As at December 31, 1931, the Pacific Company revalued all of its fixed property on the basis of estimated present replacement cost ("cost to replace new") and the application thereto of accrued depreciation computed according to the expired portion of the estimated life of each item as then determined. The difference between the depreciated value of the fixed assets, as shown by the books, and the depreciated replacement cost, was charged to "earned surplus" and credited to "reserve for revaluation of fixed assets," it being the company's intention to show depreciation in the profit-and-loss account, in future, as follows:

Depreciation based on old book values and revised lives	$........
Less: Credit from "reserve for revaluation of fixed assets"	....
	$........

No depreciation has been or is to be charged in the year of acquisition, but a full year's depreciation is to be charged in the

year of expiration or abandonment. The policy of the company has been to depreciate its fixed assets on the basis of estimated life and to revise these estimates from time to time as conditions warrant. From the following statement prepare:

(1) Annual charges for depreciation and property losses for 1932 and 1933.

(2) Statement of "reserve for revaluation of fixed assets account" for the two years ended December 31, 1933.

						Revaluation Dec. 31, 1931	
Item	Date of purchase	Cost	Original estimated life	Estimated salvage value	Dep'n reserve Dec. 31, 1931 per books	Replacement cost	Revised life from Dec. 31, 1931
1	1919	$100,000	25 years	$10,000	$ 52,000	$ 70,000	12 years
2	1920	700,000	25 "	40,000	350,000	400,000	9 "
3	"	25,000	20 "	2,000	14,000	20,000	4 "
4	"	75,000	20 "	3,000	37,500	48,000	4 "
5	1923	200,000	15 "	12,000	140,000	140,000	12 "
6	"	50,000	20 "	3,000	22,500	40,000	12 "
7	1924	400,000	25 "	12,000	148,000	300,000	23 "
8	1925	50,000	20 "	2,000	18,000	45,000	14 "
9	1926	100,000	15 "	5,000	40,000	85,000	15 "
10	"	20,000	25 "	2,000	4,800	18,000	15 "

No change was made in salvage values when the fixed assets were revalued.

Item 1 was totally destroyed by fire December 31, 1932.

Item 7 was totally destroyed by fire December 31, 1933.

Problem 222

(Pennsylvania, November, 1934)

The X Manufacturing Company manufactures highly specialized factory machinery and has been established for a number of years. In the last few years reduced sales, heavy overhead, inefficient manufacturing and faulty credits have forced a receivership which became effective as at January 1, 1934. The receiver is instructed to continue the business, and he immediately decides that manufacturing operations may be temporarily suspended without impairing the company's position in its field. Competent appraisers are appointed by the court who report on the assets on the date of the receivership as follows:

Assets	Book values	Appraised values
Cash	$ 15,000	$ 15,000
Receivables	500,000	300,000
Inventories:		
Finished machines	1,000,000	450,000
In process	50,000	20,000
Materials and supplies	300,000	280,000
Plant machinery and equipment, net of provision for depreciation	2,000,000	1,500,000
Deferred expense	50,000	
Totals	$3,915,000	$2,565,000

The appraised values were not recorded upon the company's books.

The liabilities and capital at the same date were as follows:

Notes payable	$ 750,000
Accounts payable	190,000
Accrued accounts:	
Wages	80,000
Royalties	50,000
Taxes	100,000
Other accounts	30,000
Mortgage payable	500,000
Capital stock, common	2,000,000
Earned surplus	215,000
Total	$3,915,000

At the end of January, the accounting department furnished the receiver with the following statement of operations, based upon the established procedure prior to the receivership:

Sales, finished machines, net of discounts and allowances		$125,000
Cost of sales (book value of inventory sold, net of returns)		100,000
Gross profit on sales		25,000
Expenses:		
General and administrative	$30,000	
Selling	35,000	
Interest accrued on company's indebtedness	6,250	
Total		71,250
Loss for January, 1934		$ 46,250

The receiver has instructed you (*a*) to revise the foregoing statement, giving effect to appraisers' valuations to show the operations of the receivership for the month; and (*b*) to prepare

a simple system that will enable the accounting department to report to him monthly on the results of operations, both on the book values and on the appraisal basis.

In your answer, give consideration to the following:

1. No depreciation has been charged for January, and you may disregard this factor in your answer.

2. General and administrative expense contains the following:

   a. Bad debts, $5,000 (credit to receivables).
   b. Loss on excess plant equipment sold, $10,000; net book value, $25,000, sold for $15,000.
   c. Deferred expenses absorbed, $500.

3. Appraised value of inventory sold, $55,000. Book value of machines returned to stock, $9,000; fair value, $4,000.

4. Allowances contain a total of $4,000, representing credits to customers adjusting billings made prior to December 31, 1933. The appraisers had examined these credits at the time of appraising the receivables.

5. The details of the appraisal values are available only for the inventories.

Your answer should include the necessary journal entries adequately explained and so designated that you can refer to them in answering subdivision *b* of the question as well as *a*.

SECTION XXV

MISCELLANEOUS

Problem 223

(Wisconsin, November, 1937)

The Personal Investment Company purchased collateral notes from each of four finance companies, A, B, C and D.

These notes were secured by certain automobile paper, which collateral was returned to each finance company on a trust receipt to facilitate their servicing.

Company A was required to pledge certain industrial bonds as additional security.

All four companies ran into financial difficulties which caused the Personal Investment Company to purchase the collateral, viz., the automobile paper and the industrial bonds at the four respective public sales all held on December 30, 1936. The balance of the collateral notes after applying the proceeds of the public sale of the collateral became a general claim against the remaining assets of the debtor companies.

All of the automobile paper so acquired by the Personal Investment Company was set up in one account for the combined cost, and the industrial bonds so acquired from Company A were set up in one controlling account.

The purchase price of the automobile paper, $5,000, and of the industrial bonds, $20,000, purchased from Company A, was credited by the Personal Investment Company against the original collateral note account of Company A, leaving a balance of $17,960.

The purchase prices of the automobile paper so purchased from companies B, C, and D, respectively, were credited by the Personal Investment Company against the cost of the original collateral notes of these companies.

The balances remaining on the Personal Investment Company books for the cost of the original collateral notes of companies

B, C and D were subsequently realized in full from unpledged assets of these respective companies.

No further dividends to general creditors were received from Company A.

Given the following accounts on the Personal Investment Company books:

1. Account for the original collateral notes of Company A.
2. Combined account containing all automobile paper purchased at the four public sales from companies A, B, C and D.
3. Account showing industrial bonds acquired at public sale from Company A.
4. Amount collected on automobile paper after these three accounts were closed—credited to recoveries.

The books of the Personal Investment Company were kept by an incompetent bookkeeper, and you are called upon to correct its accounts.

1. Show in four separate corrected accounts the purchases of automobile paper and subsequent liquidation of such paper so that the Personal Investment Company will have a separate accounting for each of the four purchases.
2. Show a corrected account for the original Company A collateral note account.
3. Show a corrected account of the industrial bonds purchased at public sale from Company A so that the Personal Investment Company will have a separate account for each issue.
4. Show journal entries for all debits and credits used to correct these accounts.

Collateral note of Company A

		Debits	Credits
	Balance, December 29, 1936	$42,960	
1936			
Dec. 30	Automobile paper purchased at public sale		$ 5,000
	Bonds purchased at public sale		20,000
1937			
Jan. 3	Interest on $11,000 X Paper Company bonds.		275

			Debits	Credits
May 19	Collections on automobile paper acquired from Company A at public sale on December 30, 1936			$ 3,000
June 8	Distribution to general creditors of Company A			6,300
June 9	Settlement on automobile paper acquired from Company A at public sale on December 30, 1936			100
June 9	Collections on automobile paper acquired from Company A at public sale on December 30, 1936			87
June 16	Collections on automobile paper acquired from Company A at public sale on December 30 1936			3,288
July 28	Collections on automobile paper acquired from Company A at public sale on December 30, 1936			913
Aug. 11	Same			91
Oct. 10	Distribution to general creditors of Company A			3,150
Oct. 27	Distribution to general creditors of Company A Credited as follows:			
	Here	$ 756		756
	Combined account for automobile paper purchased at four public sales on December 30, 1936	1,766		
	Account for industrial bonds purchased at public sale on December 30, 1936	628		
	Total	$3,150		
	Totals		$42,960	$42,960

Industrial bonds purchased at public sale from Company A on December 30, 1936

		Par value	Debits	Credits
1936				
Dec. 30	X Paper Company	$11,000		
	Y Paper Company	9,000	$20,000	
1937				
Feb. 1	Sale of bonds as follows:			
	X Paper Company—par $11,000			$ 9,000
Feb. 28	Charged to losses on securities to reduce carrying value of bonds			3,600
Oct. 27	Distribution to general creditors of Company A credited as follows:			
	Here	$ 628		628

		Par value	Debits	Credits
	Combined account for automobile paper purchased at public sale on December 30, 1936	$ 1,766		
	Original collateral note of Company A	756		
	Total	$ 3,150		
Oct. 31	Sale of bonds as follows:			
	Y Paper Company par $7,000 sold for $7,200 and applied as follows:			
	Here	$ 6,772		$ 6,772
	Profit on sale of securities	428		
	Total	$ 7,200		
	Totals		$20,000	$20,000

Combined account containing all automobile paper purchased at four public sales from Companies A, B, C and D, December 30, 1936

			Debits	Credits
1936				
Dec. 30	Purchased:			
	A	$5,000		
	B	8,500		
	C	500		
	D	500	$14,500	
1937				
Feb. 21	Collections on foregoing paper:			
	Company A	$3,100		
	Company B	2,675		
	Company C	500		
	Company D	194		$ 6,469
Feb. 28	Charged to bad debts to reduce carrying price of automobile paper purchased from Company A			2,000
Oct. 20	Collections on automobile paper:			
	Company A	$ 135		
	Company B	2,215		
	Company D	100		2,450
Oct. 27	Distribution to general creditors of Company A, credited as follows:			
	Here	$1,766		1,766
	Original collateral note of Company A	756		
	Account for industrial bonds purchased from Company A at public sale on December 30, 1936	628		
	Total	$3,150		

			Debits	Credits
Oct. 30	Charged to bad debts to reduce carrying price of automobile paper purchased from Company B			$ 1,000
Nov. 3	Collection on Company B automobile paper			15
Nov. 5	Charged to bad debts to reduce carrying price of automobile paper purchased from:			
	Company B	$ 595		
	Company D	205		800
	Totals		$14,500	$14,500

The recoveries account contains collections in November, 1937, as follows:

November 10—on Company B automobile paper	$1,087
November 15—on Company D automobile paper	300

These amounts were collected after the three accounts given above were closed on the books of the company.

Problem 224

(New York, November, 1931)

Five men, A, B, C, D and E, are interested in four syndicates, each of the syndicates owning blocks of stock in K Company. The respective interests are as follows:

A, B and C have contributed equally to Syndicate 1.
Syndicate 1 owns 1,200 shares of K Company stock.
B, C and D have contributed equally to Syndicate 2.
Syndicate 2 owns 1,500 shares of K Company stock.
C, D and E have contributed equally to Syndicate 3.
Syndicate 3 owns 900 shares of K Company stock.
A, D and E have contributed equally to Syndicate 4.
Syndicate 4 owns 600 shares of K Company stock.
A individually owns 300 shares of K Company stock.
B individually owns 500 shares of K Company stock.
D individually owns 200 shares of K Company stock.
E individually owns 200 shares of K Company stock.

K Company issues stock rights, one-third stock right for each of its shares outstanding, but no fractional new shares are to be

issued. The holder of three rights may purchase one share of the new issue at $56.

A and C, acting with consent of the others, produce a purchaser for the holdings of all the K Company stock owned by the five men at $83.50 per share. For this, A and C are to receive a 6 per cent commission on the gross sale, 75 per cent of the commission to be credited to C, and 25 per cent to A.

It is agreed that the five men shall pool their interests, so that the rights accruing to the stock in the consolidated pool may be exercised jointly. It is agreed, further, that the cash required to be contributed by the five persons be so contributed to exercise the rights applicable to their interests that the balance of cash received, after liquidating unpaid legal expense of $1,750, incurred by the consolidated interests, can be distributed as follows:

A	25%
B	20%
C	30%
D	10%
E	15%

The following advances have been made to defray syndicate expenses:

A had advanced $210 to defray expenses of Syndicate 1.

B had advanced $180 to defray expenses of Syndicate 2.

D had advanced $185 to defray expenses of Syndicate 3.

E had advanced $175 to defray expenses of Syndicate 4.

E had advanced $290 to defray expenses of consolidated interests.

All advances are to be treated as loans to the consolidated syndicate.

What contribution of cash must each man make to justify the foregoing distribution of the proceeds of the sale?

Problem 225

(Pennsylvania, November, 1931)

The A Building and Loan Association is in very good standing. The B Building and Loan Association, organized at a later date,

made real estate loans on a too optimistic basis, and its directors realized the danger of this condition.

The directors of A Association have been applied to and have agreed to absorb the B Association by merger. Agreement for merger has been accepted by the stockholders of both associations effective as of December 31, 1930.

The basis of the merger is that the assets of B Association are to be appraised and revalued in such manner as will provide for all anticipated losses plus a further provision for contingencies in the same ratio as established by A Association.

The merger agreement provides with respect to A Association that no change is to be made in the serial arrangement of stock or the calculated maturity basis as evidenced in the recapitulation of shares. Every shareholder of B Building and Loan Association shall be given the same number of shares in the merged association as they have standing in their names at the time of the merger. The said shares are to be consolidated with the shares in the series of A Association disclosing the next greater value and assessment made for the difference.

The secretaries of the respective associations have prepared the following statements:

A Building and Loan Association
Balance-sheet, December 31, 1930

Assets		
Cash		$ 10,506.30
Mortgage loans		198,900.00
Stock loans		42,500.00
Dues delinquent		1,810.00
Interest, etc., delinquent		825.25
Real estate		12,000.00
Total		$266,541.55
Liabilities		
Dues in advance		$ 240.00
Interest, etc., in advance		37.12
Contingent reserve		18,000 00
Due stockholders:		
Instalment dues	$192,240.00	
Profits	56,024.43	248,264.43
Total		$266,541.55

A BUILDING AND LOAN ASSOCIATION
Recapitulation of shares

Series	No. of shares	Paid in per share	Paid in per series	Profit per share	Profit per series	Book value per share
15	165	$132.00	$ 21,780.00	$56.87	$ 9,383.55	$188.87
16	205	120 00	24,600 00	47 00	9,635.00	167.00
17	235	108.00	25,380.00	38.07	8,946.45	146.07
18	325	96.00	31,200.00	30.08	9,776.00	126.08
19	350	84.00	29,400.00	23.03	8,060.50	107.03
20	225	72.00	16,200.00	16.92	3,807.00	88.92
21	265	60.00	15,900.00	11.75	3,113.75	71.75
22	205	48.00	9,840 00	7.52	1,541.60	55.52
23	295	36.00	10,620 00	4.23	1,247.85	40.23
24	230	24.00	5,520.00	1.88	432.40	25.88
25	150	12.00	1,800.00	0.47	70.50	12.47
	2,650		$192,240.00		$56,014.60	
				Undivided	9.83	
					$56,024.43	

B BUILDING AND LOAN ASSOCIATION
Balance-sheet, December 31, 1930

Assets		
Cash		$ 901.37
Mortgage loans		155,000 00
Stock loans		16,100 00
Dues delinquent		2,850 00
Interest, etc., delinquent		2,320 35
Advances to stockholders		1,057.33
Real estate equities		26,750.00
Total		$204,979.05
Liabilities		
Borrowed money		$ 32,500.00
Dues in advance		225.00
Interest, etc., in advance		63.78
Contingent reserve		5,000.00
Due shareholders:		
Instalment dues	$140,460.00	
Profits	26,730.27	167,190 27
Total		$204,979.05

B BUILDING AND LOAN ASSOCIATION
Recapitulation of shares

Series	No. of shares	Paid in per share	Paid in per series	Profit per share	Profit per series	Book value per share
1	305	$96.00	$ 29,280.00	$24 96	$ 7,612.80	$120.96
2	410	84.00	34,440.00	19.11	7,835.10	103.11
3	285	72.00	20,520.00	14.04	4,001.40	86.04
4	365	60 00	21,900.00	9.75	3,558.75	69.75
5	390	48.00	18,720.00	6.24	2,433.60	54.24
6	260	36.00	9,360.00	3.51	912.60	39.51
7	185	24.00	4,440 00	1.56	288.60	25.56
8	150	12.00	1,800 00	0 39	58 50	12.39
	2,350		$140,460.00		$26,701.35	
				Undivided	28.92	
					$26,730.27	

You are requested to audit the accounts of B Association for the year ended, apply the newly determined valuations and consolidate the accounts of the merging associations.

Your audit discloses no need for adjustment except for appraisals and accruals as follows:

1. Real estate equities are subject to first mortgages amounting to $35,000, and the properties are valued in appraisal at $51,000.
2. Valuations of mortgaged premises and consideration of arrearages indicate inescapable losses totaling $7,500.
3. Taxes unpaid for 1930 amount to $1,250.
4. Accrued interest on first mortgages amount to $819.75.
5. Accrued interest on borrowed money—$253.43.

Submit the following:

(*a*) Adjustments applicable to the accounts of B Building and Loan Association in journal form.

(*b*) Balance-sheet, December 31, 1930, for the merged association.

(*c*) Recapitulation of shares, December 31, 1930, for merged association.

(*d*) Statement of assessment against shareholders of B Association in merger showing amounts for each share and the series totals.

(*e*) Outline method of accounting for these assessments, stating your position as to propriety of charging interest on unpaid assessments.

Problem 226

(New York, April, 1934)

From the following information prepare, on an appropriate accrual basis, a statement of income and expenses for the Folio Publishing Company for the six months ended June 30, 1933:

The Folio Publishing Company started business on January 1, 1933, publishing a monthly magazine.

Circulation receipts during the six months ended June 30, 1933, were as follows:

Month of receipt of subscriptions and cash	Single-copy sales	Six-month sub-scriptions	One-year sub-scriptions
January, 1933	$ 8,000	$4,200	$27,000
February, 1933	8,500	4,500	30,000
March, 1933	9,000	5,400	30,000
April, 1933	8,900	6,600	33,000
May, 1933	9,700	6,000	36,000
June, 1933	10,500	6,900	30,000

Each subscription received became effective in the month in which it was received, and the first copy of the magazine mailed to each subscriber was that for the month in which the subscription and cash were received.

Advertising revenue for the six months was $310,000.

The cost of paper purchased was $22,000, and the paper inventory at June 30, 1933, was $4,000.

At the close of business June 30, 1933, the balances of cost and expense accounts (other than those relating to paper costs), after all proper accrual entries had been made, were as follows:

Printing and binding costs	$ 30,000
Editorial and art costs and expenses	50,000
Postage	6,000
Other mailing and delivery expenses	15,000
Circulation department salaries, commissions and other expenses	125,000
Advertising department salaries and other expenses	75,000
General administrative salaries and other expenses	80,000
Depreciation of fixed assets	20,000
Interest expense	10,000

Problem 227

(American Institute of Accountants, November, 1935)

The following statement gives the account balances on the books of a college at the end of the fiscal year before closing:

	Debit	Credit
General current funds		
Cash	$ 17,000	
Investments	20,000	
Accounts receivable	3,000	
Inventories	18,000	
Estimated income	1,385,000	
Appropriations		$1,360,000
Accounts payable		2,000
Reserve for working capital		20,000
Unappropriated surplus (after entering budget)		111,000
Educational and general expenditures	1,060,000	
Auxiliary enterprises expenditures	252,000	
Other non-educational expenditures	26,000	
Educational and general income		1,070,000
Auxiliary enterprises income		315,000
Other non-educational income		15,000
Transfer to endowment	50,000	
Transfer to plant funds	62,000	
Totals	$2,893,000	$2,893,000
Restricted current funds		
Cash	$ 3,000	
Investments	58,000	
Accounts payable		$ 1,000
Fund balances		60,000
Totals	$ 61,000	$ 61,000
Loan funds		
Cash	$ 1,000	
Investments	5,000	
Notes receivable	36,000	
Income		$ 2,000
Funds principal beginning of year		25,000
Gifts to loan funds during year		15,000
Totals	$ 42,000	$ 42,000
Endowment and other non-expendable funds		
Cash	$ 3,000	
Securities	857,000	
Funds in trust	100,000	

	Debit	Credit
Profit on sales of investments		$ 10,000
Endowment funds principal beginning of year		700,000
Gifts to endowment		100,000
State tax collections for endowment		100,000
Transfer from current funds (temporary)		50,000
Totals	$ 960,000	$ 960,000
Funds subject to annuities		
Cash	$ 1,000	
Investments	99,000	
Fund balances, beginning of year		$ 80,000
Gifts of annuity funds		20,000
Totals	$ 100,000	$ 100,000
Unexpended plant funds		
Cash	$ 4,000	
Investments	15,000	
Expenditures for plant additions	360,000	
Replacement funds balances		$ 15,000
Plant additions funds balances, beginning of year		50,000
State appropriation for plant additions		200,000
Gifts for plant additions		50,000
Income on investments		2,000
Transfer from current funds		62,000
Totals	$ 379,000	$ 379,000
Funds invested in plant		
Educational plant, beginning of year	$3,100,000	
Bonds payable		$ 100,000
Investment in plant		3,000,000
Totals	$3,100,000	$3,100,000
Agency funds		
Cash	$ 2,000	
Investments	8,000	
Fund balances		$ 10,000
Totals	$ 10,000	$ 10,000

Attention is called to the following facts and conditions which are disclosed upon examination of the records:

(1) Notes of loan fund amounting to $500 are found to be uncollectible and are to be written off.

(2) An annuity fund of $1,000 for current purposes has matured through the death of the annuitant.

(3) Included in the educational expenditures of the year from current funds is the sum of $14,000 for new equipment.

(4) Equipment included in plant assets at beginning of year to the amount of $32,000 had worn out or other disposition of it had been made.
(5) Orders and contracts outstanding at close of year and payable from current funds appropriations amounted to $6,000.
(6) An analysis of endowment funds shows that at the beginning of the year $200,000 included therein represent undesignated funds temporarily functioning as endowment.
(7) A further analysis indicates that $100,000 of endowment funds has been expended for a residence hall, the value of which is included in plant assets but not in endowment funds.
(8) Income and expenditures of restricted current funds are included in the budget estimates and in the totals of income and expenditure carried in the general-funds section.

You are required:

(a) To make the necessary closing entries in all funds.
(b) To prepare a balance-sheet after closing.
(c) To prepare a statement of current income, expenditures and surplus for the year.

Problem 228

(American Institute of Accountants, May, 1930)

Your examination of the accounts of the Smithtown Home for Children discloses the following:

The home was founded on January 1, 1930, by two men who contributed as follows: mortgages, $100,000; bonds valued at $200,000; land valued at $75,000; buildings and equipment valued at $120,000 and cash $20,000 for general purposes.

According to the trustees' minutes, the following funds were established: Smith endowment fund, $150,000, and Taylor endowment fund, $150,000, representing investments in mortgages and bonds, the income therefrom to be used for general purposes; property and equipment fund, representing the property and equipment of the institution, and general fund, representing the general funds of the institution.

The following transactions were recorded in the cashbook during the three months ended March 31, 1930:

Receipts:		
Original contribution for general purposes		$20,000
Mortgage principal		10,000
Donation for improvements to buildings		15,000
Donation for painting and repairs to buildings		5,000
Bond interest		2,500
Mortgage interest		2,500
Board and maintenance of children		5,000
Total		$60,000
Payments:		
Ice plant	$ 5,000	
Petty cash fund	100	
Board and maintenance of children	17,900	
General and administrative expenses	2,000	25,000
Balance—March 31, 1930		$35,000

At March 31, 1930, bond interest due and uncollected amounted to $500; uncollected charges for board and maintenance of children $6,000; unpaid bills for general expenses $500 and for board and maintenance of children $500.

In accordance with the above information, prepare a balance-sheet as at March 31, 1930, and a statement of income collectible and expenditures for the three months ended that date.

Problem 229

(American Institute of Accountants, November, 1930)

The trial balance of the recently organized Glenview Golf Club as at December 31, 1929 is as shown at the bottom of page 462.

A proprietary membership in the club costs $1,000, plus $100 tax.

An analysis of entrance-fees account shows that it includes [illegible] paid in, fully paying 110 memberships, and $36,250 collected from 60 members. The balance due from these 60 members, plus the tax thereon, is secured by notes for their original unpaid balance. These notes are on hand but not entered.

In September, 1929, a special committee, appointed for the purpose, handed in a statement with a list of 80 members, each of whom promised to obtain a new member and to advance the

entrance fee of such member at once, subject to repayment when the new member paid in his fee; accordingly, the following entry was then made:

Accounts receivable, members	$80,000	
To entrance fees underwritten		$80,000

Of the above $80,000, $70,000 had been collected from the underwriters at December 31, 1929. Nothing has been repaid to the underwriters on account of new members, although 10 such new members had been elected in December and had paid in $8,800 in cash and signed notes for $2,200 for entrance fees and taxes.

Dues are $200 a year, plus 10 per cent tax, payable quarterly in advance, and have been chargeable and entered on April 1, July 1 and October 1, 1929.

Included in "accounts receivable, members," are accounts totaling $330 for dues and taxes against 2 members who have been delinquent for nine months, and accounts [illegible] $770 for dues and taxes of 8 other members. Collections can be enforced only by deduction from the proceeds of sale of such memberships after the complement of 300 members is attained.

	Debits	Credits
Cash in bank	$ 7,225	
Accounts receivable, members	11,160	
Buildings	54,500	
Equipment	8,500	
Golf-course construction	130,000	
Labor	26,285	
Golf-course supplies and expense	12,446	
General expense	4,213	
Interest paid	5,617	
Rent	6,000	
Commissions—soliciting membership	1,100	
Notes payable—bank		$ 10,000
Accounts payable		2,341
Entrance fees		146,250
Dues		22,950
"Green" fees		5,015
Taxes on dues and entrance fees		490
Entrance fees underwritten		80,000
Totals	$267,046	$267,046

The building account includes:

Caddy and locker house	$10,000
Architect's plans for a club house, discarded as proposal appeared too expensive	3,000
Architect's fees for new house	1,500
Payments under a cost-plus contract for the club house (under construction December 31, 1929) with a guaranteed maximum cost of $50,000	40,000
Total	$54,500

The golf course was finished and opened on June 30, 1929. At that date, the club being obliged to maintain the course since the original construction contract was completed, the operating accounts stood as follows:

Debits—	
Labor	$10,116
Golf-course supplies and expense	4,539
General expense	916
Interest paid	2,890
Rent	6,000
Credits—	
Dues	5,950

The club leases its real estate, for which it pays an annual rental of $6,000, payable January 1st in advance.

The estimated life of the equipment is five years from June 30, 1929.

Of the liability on the books for taxes on dues, $390 is now payable to the collector of internal revenue, representing collections in December.

Prepare the journal entries which should be made on the books as of December 31, 1929, and January 1, 1930, disregarding closing entries, as the fiscal year ends June 30th.

Submit, also, statement of assets and liabilities as of the opening of business on January 1, 1930.

Problem 230

(New York, April, 1935)

A company was formed to operate a mausoleum. A contract was given for its construction at a cost of $500,000. Erection of the building was begun; and during the construction period, sales of crypts and niches were made to the public.

At the end of the company's first year of operations, the books of account, in part, showed the following accounts:

Sales of crypts—for interments	$100,000
Sales of niches—for ashes	15,000
Payments to contractors for construction to date	150,000

The company records showed that during this first year 10 per cent of each class of crypts and niches were sold, as follows:

Crypts:	
160 at $ 200 each	$ 32,000
70 at 400 each	28,000
30 at 600 each	18,000
22 at 1000 each	22,000
Total	$100,000
Niches:	
100 at $100 each	$10,000
20 at 250 each	5,000
Total	$15,000

The charter of the Mausoleum Company requires the provision of an upkeep fund equal to 12 per cent of the sales price of crypts and niches. The accumulations in this fund are to be invested in securities legal for savings banks, so that when all crypts and niches have been sold the fund will be available for the perpetual care of the mausoleum.

The sales price of crypts and niches to the public includes the services of opening and closing crypts and niches when an interment occurs, the cost to the company for this service being $18 for each crypt and niche. Most sales, however, were made to persons who purchased for future, rather than for present, use; many crypts and niches will not be used for years. The same is believed to be true of future sales.

From the information given above

1. Make whatever adjustments are necessary.
2. Determine the cost of sales for the year.

Problem 231

(American Institute of Accountants, November, 1933)

On January 1st the inventory at market values of working cattle and live stock on a plantation in the West Indies was as follows:

	Number	Unit Price	Amount
Work animals (bulls and oxen)	1,588	$ 52	$ 82,576
Horses	16	120	1,920
Cows	274	30	8,220
Heifers	137	20	2,740
Young bulls	220	30	6,600
One year heifers (under two years)	82	15	1,230
One year bulls (under two years)	127	20	2,540
Bull calves (under one year)	137	10	1,370
Heifer calves (under one year)	114	10	1,140
Breeding bulls	6	150	900
Together	2,701		$109,236

During the year, the following changes took place:

Births—
145 bull calves
130 heifers
Deaths—
261 work animals
5 cows
4 heifers
3 bull calves
Found—
8 work animals
12 bull calves (new)
5 heifer calves (new)

Purchased (all on hand at the end of the year)—
120 work animals at $45
41 young bulls at $30
Sold—
63 work animals
4 cows
2 horses
Lost—
7 work animals

During the year 73 heifers were reclassified as cows and 175 young bulls as work animals. All of them were on hand at the end of the year.

The market values remained the same throughout the year except that work animals were worth $43 a head at the end of the year.

Prepare:

1. A columnar statement showing opening and closing inventories with number, unit price and value, together with all numerical changes during the year, making such further adjustments as may be necessary.

2. A statement showing the amount of the opening inventory, the amounts of increases through appreciation, purchase, birth, etc., and of decreases through reduction in market value, sales and losses, thus arriving at the amount of the closing inventory.

Problem 232

(American Institute of Accountants, November, 1930)

The Pine Lumber Company is the owner of a tract of timber, of which it is estimated there will be 1,330,000,000 feet remaining to be cut at January 1, 1931. It intends to cut off this timber and manufacture it over the ensuing ten years, and its present plant, main-line railroad and equipment will be adequate for that purpose with normal replacements.

In the analysis of the accounts for the three years ended June 30, 1930, the following items of expenditure were shown:

New plant extension	$385,750
Plant and main-line railroad replacements	101,070
Equipment replacements	116,480
Construction of logging spurs	217,300
Total	$820,600

Plant and main-line railroad replacements as above may be considered normal for a three-year period under the usual operating conditions. Equipment replacements may, likewise, be assumed to be normal, but it is to be expected that necessary purchases of new equipment will depend on the number of feet cut.

It is estimated that the construction of logging-railroad spurs into 1,000,000,000 feet of the remaining timber will cost $900,000; spurs already constructed are available for logging 330,000,000 feet.

The company's operations for the three years from June 30, 1927, to June 30, 1930, during which it manufactured 364,000,000 feet of lumber, are summarized as follows:

Net sales of lumber and inventory adjustments		$8,736,000
Cost of sales:		
Logging, manufacturing labor and expense	$6,576,770	
Amortization of logging-railroad spurs	172,900	
Depreciation, plant and main-line railroad	213,500	
Depreciation, equipment	133,910	
Depletion of timber	728,000	7,825,080
Gross profit		$ 910,920
Selling and administrative expenses, taxes, etc.		976,230
Operating loss		$ 65,310
Interest paid		158,850
Net loss for the three-year period		$ 224,160

In order to liquidate all of its present indebtedness, the company is about to negotiate a loan for $1,000,000, to be dated January 1, 1931, with interest at 6 per cent, per annum on the unpaid balance, the principal payable in ten equal annual instalments beginning December 31, 1931.

Using sales prices and expenditures as experienced for the three years to June 30, 1930, as a basis:

Prepare a statement of the "conversion value" of the timber remaining at January 1, 1931, that is, the cash funds to be realized from the operations of the company available for liquidation of the principal under the proposed loan or for other purposes. Calculate the "conversion value" or cash funds to be realized per thousand feet of timber to be cut, to the nearest tenth of a cent.

Prepare also a statement comparing payments to be met in each year under the proposed loan with the cash funds to be available each year, assuming that all the timber will be cut and manufactured in equal annual amounts.

NOTE.—The foregoing relates to the determination of "conversion value" now commonly required by long-term creditors of timber operators, and requires statements other than the orthodox balance-sheet and profit-and-loss statement.

Problem 233

(Pennsylvania, November, 1931)

The rates of the X Telephone Company were approved by the Public Service Commission as of January 1, 1928—on the basis of a fair return of 7 per cent allowing a value of $4,500,000 for the fixed assets as at January 1, 1928, and an annual depreciation of $165,000. Subsequently in 1930 the reasonableness of the company's rates was again questioned in a proceeding before the Public Service Commission.

The operating statements of the company for the two years 1928-1929 showed the following information:

Comparative statements of income (per books)

Telephone operating revenue	1928		1929	
Exchange service.......	$1,100,000		$1,210,000	
Toll service............	100,000		120,000	
Miscellaneous operating.	50,000	$1,250,000	70,000	$1,400,000

Comparative statements of income (per books).—(*Continued*)

	1928		1929	
Telephone operating expenses				
Maintenance:				
Current	$ 200,000		$ 220,000	
Depreciation of plant and equipment	250,000		275,000	
Extraordinary depreciation for storms	20,000		25,000	
Traffic	75,000		80,000	
Commercial	80,000		85,000	
General and miscellaneous:				
Relief department and pensions	50,000		25,000	
Other	60,000	$ 735,000	70,000	$ 780,000
Net telephone operating revenue		$ 515,000		$ 620,000
Interest revenues		10,000		10,000
Miscellaneous nonoperating revenue		3,000		2,000
Totals		$ 528,000		$ 632,000
Deductions				
Uncollectible operating revenue	$ 10,000		$ 15,000	
Taxes assignable to operations, state capital stock, loans, etc.	25,000		30,000	
Federal income tax	80,000		95,000	
Rent expense	500		500	
Nonoperating taxes	2,000		2,000	
Rent deductions	10,000		15,000	
Interest deductions on funded debt	100,000		100,000	
Other interest deductions	1,000		2,000	
Amortization of debt discount and expense	5,000		5,000	
Dividend appropriations	150,000	383,500	175,000	439,500
Net income to surplus		$ 144,500		$ 192,500

Comparative summary balance-sheets

Assets	December 31, 1927	December 31, 1928	December 31, 1929
Fixed capital installed	$5,500,000	$5,700,000	$6,000,000
Reserve for accrued depreciation	1,000,000	1,250,000	1,525,000
Net	$4,500,000	$4,450,000	$4,475,000

Comparative summary balance-sheets.—(*Continued*)

Assets (Continued)	December 31, 1927	December 31, 1928	December 31, 1929
Investment securities	100,000	175,000	350,000
Cash and deposits	200,000	250,000	250,000
Bills receivable	25,000	29,000	30,000
Due from subscribers and agents	50,000	60,000	40,000
Miscellaneous accounts receivable	10,000	15,000	20,000
Materials and supplies	200,000	250,000	267,000
Prepaid rents and taxes	10,000	15,000	20,000
Unamortized debt discount and expense	100,000	95,000	90,000
Totals	$5,195,000	$5,339,000	$5,542,000
Liabilities			
Capital stock	$2,000,000	$2,000,000	$2,000,000
Funded debt	1,600,000	1,600,000	1,600,000
Bills payable (banks)	25,000	19,500	20,000
Audited vouchers and wages unpaid	100,000	75,000	50,000
Taxes accrued federal	80,000	90,000	100,000
Corporate surplus unappropriated	1,390,000	1,534,500	1,727,000
Reserve for extraordinary depreciation (storms)		20,000	45,000
Totals	$5,195,000	$5,339,000	$5,542,000

Collateral data:

1. During 1928 the directors authorized the creation of a pension fund to start January 1, 1928, and accordingly $35,000 was appropriated to the principal of said fund and $15,000 for the 1928 initial payment. For 1929 the payment to the reserve pension fund amounted to $25,000.

2. As of December 31, 1927, the Public Service Commission found and determined the present fair value of this company's property to be the amount set forth for that date in the comparative balance-sheets herewith, after giving consideration to the amount of accrued depreciation there shown. The commission also found a fair allowance for annual depreciation on fixed capital installed to be $165,000 per annum. Nothing was mentioned by the commission at that time with respect to any provision for extraordinary depreciation for storms.

3. Assume that the commission's basis of valuation and accrued depreciation of fixed capital installed prior to December 31, 1927, and of annual depreciation is not to be changed for the present.

4. During 1928 and 1929 the company continued its previous policy of computing annual depreciation on the basis of appraised values of property, and annual rates which produced an annual depreciation charge higher than that approved by the commission. The property additions during 1928 and 1929 were considered by the company to have a useful life of twenty years.

5. The company estimates capital expenditures of $300,000 to be spent within the next eighteen months.

6. The company claimed that the annual operating expenses would be increased by $50,000 exclusive of depreciation after said properties are put into service and that $10,000 of said increase would represent proposed increases in salaries and wages of certain employes.

Question. With this information before you, prepare in report form, your views upon the following matters for use by the complainants in presenting this matter for consideration by the commission:

1. The extent to which the operating results justify the fair return of 7 per cent.
2. The propriety of including federal income taxes as an operating expense.
3. The allowance for depreciation.
4. The allowance or disallowance of reserve for storms, creation of pension fund, reserve for possible increase in operating expenses due to anticipated expansion of service.
5. Allowance for a fair return upon fixed assets not as yet acquired but anticipated in connection with possible expansion of service.

Problem 234

(American Institute of Accountants, November, 1937)

From the following data, prepare a balance-sheet of the XYZ company as at December 31, 1936: submit all work sheets.

Trial Balance After Closing December 31, 1935

	Debits	Credits
Cash	$ 75,000	
Dividends receivable ($2 per share on 1,500 B)	3,000	
Other accounts receivable	1,000	
Marketable securities at average cost detailed below	865,000	

TRIAL BALANCE AFTER CLOSING DECEMBER 31, 1935.—(*Continued*)

	Debits	Credits
Deferred charges	$ 1,000	
Furniture and fixtures	10,000	
Reserve for depreciation of furniture and fixtures		$ 6,000
Accounts payable and accrued expenses		2,000
Reserve for estimated Federal income taxes—1935		10,000
Capital stock { authorized—100,000 shares @ $10 par; issued and outstanding—50,000 shares		500,000
Capital surplus		300,000
Earned surplus		137,000
Totals	$955,000	$955,000

MARKETABLE SECURITIES ON HAND DECEMBER 31, 1935

Shares	Security	Average cost
1,000	A	$ 90,000
1,500	B	120,000
600	C	60,000
1,500	D	95,000
1,200	E	85,000
1,000	F	130,000
800	G	85,000
1,000	H	70,000
2,000	I	130,000
	Total	$865,000

SECURITY TRANSACTIONS—1936

Purchases

		Shares		Cost			Shares		Cost
March	20	200	A	$ 20,000	July	15	300	K	$ 40,000
April	15	500	B	50,000	July	25	200	G	20,000
April	25	200	J	15,000	August	15	200	G	25,000
May	10	300	J	25,000	September	15	1,000	K	90,000

Sales

		Shares		Selling price			Shares		Selling price
January	15	200	A	$ 19,000	July	20	500	A	$ 50,000
March	10	200	F	30,000	August	20	1,000	H	30,000
April	10	1,200	E	110,000	September	15	1,000	B	125,000
June	15	300	F	50,000					

OTHER DATA

Purchased on December 15, 1936: 200 shares of XYZ Company for $3,000.

Cash dividends received—1936: A $5,000; B $12,000; D $4,000; F $6,000; G $5,000; I $9,000; J $1,000.

Accounts receivable collected and debts paid.
Stock dividend received June 15, 1936: H—100%.
Expenses accrued and paid—1936: $20,000.
Federal capital-stock tax paid July 20, 1936: $1,000.
Dividends paid December 10, 1936: $2 per share.
Purchased December 31, 1936, for delivery and payment January 2, 1937: 200 shares G $25,000.
Dividends declared in 1936 payable in 1937:
H at each $1 per share to stockholders of record December, 1936
D at each $1 per share to stockholders of record January 2, 1937
Market value of marketable securities at December 31, 1936: $950,000.
Federal income taxes paid for the year 1935: $9,000.
Federal income taxes for the year 1936 estimated at $12,000.

Problem 235

(New York, April, 1935)

The following information has been summarized from the account balances found in the books of the Bailet-Portage Corporation, automobile dealers, at the close of the three-months period ended March 31, 1932:

Cash	$ 1,257.81	
Notes receivable	1,573.57	
Accounts receivable	6,943.49	
Inventories:		
New cars	12,159.16	
Used cars	1,764.75	
Parts	139.04	
Accessories	613.68	
Gasoline, oil, grease	110.46	
Machinery, tools, equipment	542.99	
Advertising signs	434.45	
Office furniture and fixtures	1,283.12	
Deferred and prepaid charges	1,336.94	
Notes payable		$ 4,593.44
Accounts payable		4,137.80
Deposits payable—customers		2,214.50
Net worth		10,234.12

Sales:		
New cars (32)		$25,922.35
Used cars (26)		6,312.68
Parts		649.47
Accessories		851.66
Gasoline, oil, grease		91.54
Repair labor		461.33
Cost of sales:		
New cars (32)	$ 9,531.93	
Used cars (26)	6,348.15	
Parts	1,774.38	
Accessories	581 51	
Gasoline, oil, grease	581 51	
Repair labor	674.49	
Freight and storage	1,008.81	
New car expense	52.31	
Used car expense	68.11	
Shop wages and supplies	1,029.37	
Sales salaries and expense	3,133.32	
General salaries and expense	2,674.70	
Financial income and expense—net		149 16
Totals	$55,618.05	$55,618.05

Explanations of certain of the preceding items are:

1. Freight and storage: freight and handling, $939.82; storage, $68.99.

2. Shop wages and supplies: wages, $819; supplies, $210.37.

3. Sales salaries and expense: salaries and commission, $1,125.90; demonstration expense, $322.63; advertising, $1,509.79; returns and allowances, $175.

4. General salaries and expense: salaries, $1,739.45; expense, $685.03; supplies, $250.22.

5. The capital stock authorized was 200 shares of $100 par value. Unissued capital stock consisted of 88 shares.

Further information was secured as follows:

1. Inventories on hand: new cars, $2,847.88; used cars, $7,083.18; parts, $1,278.05; accessories, $441.95; gasoline, oil, grease, $531.61.

2. Expense of reconditioning used cars in the unentered amount of $31.20 is to be apportioned as follows: cost of sales of accessories, $15; shop wages, $16.20.

3. Used cars traded in during the period have not been entered in the amount of $4,235; application to be direct to customers' accounts.

4. An examination of the gasoline, oil and grease inventory showed quantities consumed as follows: new car department, $61.68; used-car departmnt $7.25; supplies for shop, $9.54.

5. The following credit sales were omitted: parts, $126.35 (cost $66.22); accessories, $375.93 (cost $266.15); gasoline, oil, grease, $51.30 (cost $30.11); repair labor, $312.29 (cost $124.03).

6. An allowance of $100 on the sale of a new car is missing. The sale was made on credit.

The fixed assets may be considered as having been in existence two years and three months. No depreciation was taken during the time. Use a 10 per cent rate.

The following summary covers what may be considered as an average six-months period. This summary is usable for expense-distribution purposes.

Cost of sales per sales book before adjustments

Month (1931)	New cars	Used cars	Parts	Accessories	Gas, oil, grease	Total
March	$12,159.16	$ 2,999.75	$ 72.82	$ 347.53	$11.88	$15,591.14
April	10,697.70	5,401.50	23.96	31.52	16.75	16,171.43
May	13,626.55	3,705.00	14.32	425.85	12.85	17,784.57
June	13,788.24	2,996.00	12.80	232.15	5.69	17,034.88
July	5,126.80	3,514.00	17.33	58.23	10.38	8,726.74
August	1,358.35	2,244.40	90.95	30.00	12.60	3,736.30
Totals	$56,756.80	$20,860.65	$232.18	$1,125.28	$70.15	$79,045.06

Requirements:

1. Balance-sheet in account form.
2. Profit and loss statement departmentalized and analyzed to show the net operating profits for each of the five principal departments and the net profit or net loss per new and per used car sold.

Problem 236

(Ohio, May, 1936)

The ABC Hotel Company organized in 1924 completed the construction of its main building by December 31, 1925. The

building was financed from the sale of 5 per cent land trust certificates, $1,000,000 ($1,000 each) interest payable semi-annually on January 1 and July 1.

An annex, completed by December 31, 1930, was constructed at a cost of $500,000 on ground leased from the EFG Bus Company, the first floor and basement to be used by the Bus Company in lieu of ground rent, and the lease to be for twenty years. If the lease is not renewed, the Bus Company agree to pay $100,000 for the building. The annex was financed from the sale of 6 per cent cumulative preferred stock for $250,000 and a leasehold mortgage at 6 per cent per annum for $250,000.

The trustee for land trust certificate holders threatened to take action to collect delinquent ground rent due from the ABC Hotel Company for two years to June 30, 1935, for the reason that he has been unable to pay interest on land trust certificates during that period. All ground rent payments were made on time prior to July 1, 1933.

An application made as of June 30, 1935, for a mortgage loan has been granted to be disbursed as of December 31, 1935, on the following basis:

Land trust certificate holders to accept in payment of certificates outstanding 50 per cent in cash and 50 per cent in a new issue of stock of the ABC Hotel Company, preferred 6 per cent noncumulative. The certificate holders have agreed to take also in payment of delinquent interest due up to December 31, 1935, a new issue of Class A common stock with par value of $10.

From the ground rent received, the trustee has paid interest on certificates outstanding at the close of each period, deducted $750 at each interest date for fees and retired certificates at par with cash remaining. All taxes are payable by the ABC Hotel Company.

The holders of the leasehold mortgage have executed a stand-by agreement subordinating their claim to the new mortgage, provided they receive 1 per cent per month for interest and principal.

The loan has been approved to include also the payment of accrued trustee's fees to December 31, 1935; payment of bank loans in full; $10,000 as part payment on leasehold mortgage; accrued taxes and interest due December 31, 1935; and loan expense amounting to $27,500. The trustee will transfer the property by deed to the ABC Company.

The appraiser's report accepted for the purpose of the loan included the following values:

	Cost to reproduce new	Depreciation
Land	$ 500,000	
Hotel—main building	1,500,000	$300,000
—annex	500,000	50,000

The appraisal of the annex considers physical depreciation only, without regard to ownership.

The correct amounts of accrued and prepaid items at December 31, 1935, are as follows:

Unexpired insurance	$ 7,500
Accrued taxes:	
Real estate (one-half due)	18,000
All other (due)	2,000
Accrued interest:	
Due on bank loans	600
Due on leasehold mortgage	6,300
Depreciation and amortization reserves were adjusted as of June 30, 1935	

The holders of the present preferred stock accept 50 per cent in new Class A common stock at $10 per share in full settlement of accumulated dividends for three years to December 31, 1935.

Assets	June 30, 1935	December 31, 1935
Cash	$ 10,000	$ 35,000
Accounts receivable	24,000	26,000
Inventories	30,000	33,000
Land—at appraisal, December 31, 1925	450,000	450,000
Hotel—additions main building	100,000	100,000
annex	500,000	500,000
Equipment	450,000	450,000
Deferred charges	6,000	6,000
Totals	$1,570,000	$1,600,000
Liabilities		
Accounts payable	$ 50,100	$ 40,100
Notes payable—bank loans @ 6%	20,000	20,000
Accrued ground rent	140,000	175,000
Accrued taxes—real estate	9,000	9,000
All other	1,000	1,000
Accrued interest	6,900	6,900
Leasehold mortgage payable—6%	210,000	210,000

Liabilities (*Continued*)	June 30, 1935	December 31, 1935
Reserve for depreciation:		
Hotel—additions main building 2%	$ 10,000	$ 10,000
Equipment 4%	151,000	151,000
Reserve for amortization—annex	90,000	90,000
Capital stock:		
Preferred $100 par 6% cumulative	250,000	250,000
Common—no par—6,000 shares outstanding	300,000	300,000
Surplus—capital by appraisal, December 31, 1925	250,000	250,000
—earned	82,000	87,000
Totals	$1,570,000	$1,600,000

You are to prepare:

Statement of trustee's cash account to December 31, 1935.

Statement showing amount of loan and disposition of the proceeds.

Journal entries for the ABC Hotel Company's books to give effect to the loan.

Balance-sheet of the ABC Hotel Company as of December 31, 1935, after all adjustments caused by the loan and its disbursements, etc.

THEORY QUESTIONS

THEORY QUESTIONS

General Questions on Balance Sheet

1. Into what groups are assets and liabilities divided on a balance-sheet? Why?

(*District of Columbia, May, 1931*)

2. (*a*) What items in the balance-sheet of a manufacturing and trading concern would you normally classify as current assets and current liabilities?

(*b*) State upon what tests you would rely to determine whether items in part or in whole were properly classified under such headings.

(*American Institute of Accountants, November, 1933*)

3. What is your conception of a current asset?

Give your reasons for the inclusion in or exclusion from current assets of the following items at December 31, 1931:

(*a*) Securities having a readily realizable market value at the balance-sheet date. These identical securities have been owned for two years, and the management states that the intention is to hold them until the funds represented therein are needed.

(*b*) Unexpired insurance premiums.

(*c*) A note receivable for $100,000 which falls due January 4, 1933.

(*d*) Inventories of obsolete parts whose sale is somewhat problematical. A supply of these parts is necessary in order to service old-style machines which are still in use throughout the country.

(*e*) Unamortized bond discount, all of which will be charged off during the coming year.

(*f*) Cash deposited in special dividend account for the express purpose of paying a dividend already declared and due ten days following the balance-sheet date.

(*g*) Cash in hands of sinking-fund trustee, all of which is to be used to retire serial bonds and meet interest payments maturing within eight months after the balance-sheet date.

(*District of Columbia, May, 1932*)

4. Should "prepaid Ohio sales tax receipts" be classified as a current asset or a deferred charge? Defend your decision.

(*Ohio, October, 1937*)

5. Distinguish between prepaid expenses and deferred charges and their classification for balance-sheet purposes.

(*District of Columbia, May, 1936*)

6. Explain the following quotation, and indicate your reasons for agreeing or disagreeing with it:

"The excess of the gross amount of an obligation over the net proceeds received therefrom represents interest payable at maturity, and on a balance sheet the unaccrued portion of such interest should appear as a reduction of the face value of the indebtedness."

(*District of Columbia, November, 1936*)

7. Describe the proper accounting treatment of experimental and development expenses of a manufacturing concern.

(*Ohio, May, 1937*)

8. On what basis should the following assets be valued:

(*a*) Accounts receivable of trade customers.
(*b*) Raw material, work in process and finished goods inventories.
(*c*) Short-term investments.
(*d*) Entire capital stock of another corporation.
(*e*) Plant and equipment.

(*Ohio, May, 1936*)

9. (*a*) What relation does goodwill bear to capital surplus? Should you deduct one from the other? How should you eliminate either account? How is each account created?

(*b*) Expenditures on plant and construction fall in four general classes. Name the four, and prepare a brief explanation of the

nature of the items and how they should be treated on the books.

(Ohio, May, 1935)

10. Explain fully, with reasons, whether and under what circumstances, if at all, each of the following procedures may or may not be justified:

(*a*) Treating cash as a noncurrent asset.

(*b*) Capitalizing the cost of scrubbing the floors and walls of a manufacturing plant building.

(*c*) Charging to expense the premiums paid by a corporation on a policy insuring the life of its president.

(*d*) Charging the cost of oil and gasoline to plant and machinery account.

(Ohio, November, 1936)

11. Indicate your disposition of the following expenditures by a manufacturing corporation, giving your reasons in each case:

(*a*) A new battery, spotlight and axle for the delivery truck.

(*b*) Life insurance premium on policy on president's life, authorized by board of directors, where the president is permitted to name the beneficiary.

(*c*) Art work to be used in advertising.

(*d*) Sodding and landscaping area in front of office.

(*e*) 1928 real estate taxes, assessed and paid in 1929.

(*f*) Special repaving assessment levied by city.

(*g*) An electric sign erected on the roof of the factory.

(*h*) Attorney's and auditor's fees incurred in purchase of a competitor's business.

(District of Columbia, May, 1930)

12. (1) What is "accounting control" as distinct from mere "ledger control"?

(2) State briefly how it may be applied in relation to:

(*a*) Plant and equipment
(*b*) Inventory
(*c*) Liabilities
(*d*) Income and expenses

(3) Is it always desirable? What could take its place in a control of a varied stock of supplies or retail merchandise?

(American Institute of Accountants, May, 1935)

13. (*a*) What is a "hidden" or "secret" reserve?

(*b*) When intentionally created, what four reasons, valid or not, are usually advanced in justification?

(*c*) Should an auditor ever approve such reserves?

(*American Institute of Accountants, May, 1934*)

14. Assuming that you find an account, under the title of "reserves," that includes the accounts listed below, what adjustments should you suggest?

Reserve for reduction of inventory	$ 25,000
Provision for plant depreciation	100,000
Provision for amortization of leasehold	25,000
Provision for bad debts	20,000
Premium on capital stock sold	10,000
Provision for federal income taxes	5,000
Deposits on containers	5,000
Provision for redemption of preferred stock	10,000
Total	$200,000

(*Ohio, May, 1935*)

15. (*a*) What is meant by the term "window dressing" in connection with the preparation of balance-sheets?

(*b*) How should you treat $50,000 of checks dated December 31, 1936, and entered in the disbursement record on that date that have not yet been mailed to creditors but are still in the vault on January 18, 1937?

(*c*) What effect has the use of the "natural business year" upon the balance-sheet of a company that previously used a calendar-year closing?

(*Wisconsin, November, 1937*)

16. You are to audit the accounts of the Kaslek Manufacturing Company at December 31, 1933, and your certified balance-sheet is to be used for credit purposes. On December 28, 1933, the corporation sold a piece of idle property, the terms of sale being one-third cash, one-third in a note due in 30 days and one-third in a note due in 60 days. The price was determined by outside appraisal of October 15, 1933, and your investigation revealed that the transaction was apparently regular in every way. There were the proper resolutions in the minutes and all the necessary documents were produced for inspection. You also find that the cash had been duly deposited. You discover, however, that

the purchasing company is controlled by a stockholder of your client, and you suspect that the transaction took place for the purpose of window dressing. On the date of your examination the first note is unpaid and the second note is not yet due. It more than doubled the current assets and therefore greatly improved the current asset position.

How will you deal with these facts in the balance-sheet and certificate?

(*American Institute of Accountants, November, 1934*)

17. Suggest six important points that should be brought out clearly in annual financial statements sent to stockholders.

(*Wisconsin, November, 1934*)

18. (*a*) Describe briefly your understanding of the term amortization.

(*b*) List assets that are usually amortized, and set forth the method of determining the amount of amortization to be charged per period.

(*Ohio, May, 1937*)

19. What are some of the principal classes of contingent assets? Should they be mentioned in the balance-sheet?

(*District of Columbia, November, 1936*)

20. What is your understanding of the following terms?

Assets.	Liabilities.
Floating assets.	Funded debt.
Deferred charges to operation.	Capital liabilities.
	Working capital.
Permanent assets.	Reserve account.
Intangible assets.	

(*Ohio, November, 1931*)

21. State briefly your understanding of the meaning in accountancy of the following terms:

Working fund
Fund balance-sheet of a municipality
Debenture
Escrow
Hypothecation

Depreciation
Obsolescence
Amortization.

(*American Institute of Accountants, November, 1935*)

22. What is your [illegible] of the character of the following accounts? Indicate their place in the financial statements of a corporation.

(*a*) Reserve for uncollectible accounts.
(*b*) Certificates of deposit.
(*c*) Accrued interest receivable.
(*d*) Unabsorbed factory burden.
(*e*) Reserve for federal income tax.
(*f*) Reserve for loss on uninsured property.
(*g*) Goodwill arising through consolidation.
(*h*) Leasehold improvements.

(*District of Columbia, May, 1932*)

23. What do you understand by "market" in the expression "at the lower of cost or market"?

(*Wisconsin, November, 1936*)

Special Questions on Balance-sheet Items

Cash

24. The cash account of the O. K. Company at December 31, 1929, has been analyzed by you as follows:

Certificate of deposit	$ 1,000.00
Petty cash fund	100 00
Undeposited receipts	5,368.19
Cash in banks	128,416.19
Cash in branch offices	500.00
Total per books	$135,384.38

You find that $75,000 had been received December 26, 1929, in connection with a bond issue, the proceeds of which are to be used exclusively for necessary additions to plant. You also learn that there is an agreement with the bank that the O. K. Company will keep on hand at all times a deposit equal to 20 per cent of its bank loan of $80,000.

How should these items be treated on the balance-sheet?

(*District of Columbia, May, 1930*)

25. The Y Corporation on December 31, 1929, shows the following balances in its accounts with banks:

1st	Nat.	Debit balance	$20,000
2nd	"	Overdraft	*5,000*
5th	"	Debit balance	10,000
		Total agreeing with cash account	$25,000

State how you would show these balances on your balance-sheet and explain why.

In what circumstances would you modify your decision?

(*American Institute of Accountants, November, 1930*)

26. At the end of the fiscal year a company's accounts show overdrafts in its two banks.

The account with the First National Bank shows an overdraft of $1,000 but there are outstanding checks aggregating $3,000, and the bank certificate shows a balance of $2,000 to the company's credit.

The account with the Second National Bank shows an overdraft of $1,200 but checks to the amount of $4,000 are outstanding, and the bank certificate duly shows a credit balance of $2,800. The $4,000 outstanding checks are for good reasons held in the treasurer's department. They were produced for the auditor's inspection and soon thereafter mailed to the payees. No discrepancies or irregularities are found after the usual thorough check of the cash transactions.

How will you deal with this on the balance-sheet and on the books? Give reasons.

(*American Institute of Accountants, May, 1937*)

27. Entering upon the audit of the A B Corporation you discover that in accordance with its usual custom it has held open its books for fifteen days after the end of its fiscal year and has entered, as of the closing date of said year, the collections of open accounts and cheques drawn in payment of purchase and expense bills, bearing dates prior to the end of the year. No other transactions during the fifteen days are so entered.

Discuss the probable reason for and the effect of this procedure, and state what action you would take in the matter. Give your reasons.

(*American Institute of Accountants, November, 1935*)

Receivables

28. Outline a system of internal check relating to the accounts receivable of a large manufacturing company.

(*Wisconsin, November, 1934*)

29. Do you regard it necessary to segregate on the balance-sheet accounts receivable from employees representing sales, and accounts due from affiliated companies? Explain.

(*Wisconsin, November, 1935*)

30. Explain how customers' accounts are analyzed as a basis for estimating bad debts.

Explain two methods of estimating bad debts by percentage, and give a criticism of each.

(*Ohio, May, 1933*)

31. You are informed by a client that because none of numerous notes from customers is past due, no reserve for bad debts is required. What circumstances might compel you to disagree with him?

(*District of Columbia, May, 1936*)

32. C Company from time to time sells its accounts receivable to a discount corporation, with recourse, 80 per cent of the account being advanced in cash. What balance-sheet notations does this call for? How should you as an auditor determine the unpaid accounts at the balance-sheet date?

(*Wisconsin, November, 1936*)

33. How should receivables be classified that represent (*a*) "retained percentages" withheld by customers pending completion of contracts and (*b*) deposits on bids?

(*Wisconsin, November, 1935*)

34. The X. Y. Corporation shows on its balance-sheet, among its assets, the following items:

Notes receivable	$300,000
Accounts receivable	200,000
Total	$500,000
Less reserves	150,000
Balance	$350,000

What criticisms have you to offer? State the principle involved.

(*American Institute of Accountants, May, 1933*)

35. In the annual audit of the firm of John Doe & Co. you find it has sold a substantial part of its accounts receivable to the X Discount Co., receiving an advance of 60% of their face value, the balance to be received when and as the accounts are collected from customers.

The advance was credited to the account of The X Co. when received, but in closing its books for the year the firm has deducted it from the total accounts-receivable balance on the theory that the accounts sold no longer belong to the firm and that the 40% equity in them is due from the purchaser.

You are requested to certify the resulting balance-sheet in this form without mentioning the sale of the accounts, if possible.

(a) Analyze the above transaction, and

(b) State three methods from which you could choose in order to give a certificate, qualified or unqualified.

(c) Which method would you adopt? Give your reasons.

(*American Institute of Accountants, November, 1934*)

36. (a) Define "trade acceptance." (b) What is its distinguishing characteristic? (c) As compared with customary trade methods of book accounts what are its advantages and disadvantages (1) to the parties thereto, (2) to the auditor, and (3) to business in general?

(*American Institute of Accountants, November, 1932*)

37. In auditing the books of Roe & Co. you find among the notes receivable one endorsed by John Doe, which is six months overdue, the maker having refused to pay it. You learn that Roe & Co. have neglected to notify John Doe of the default.

At the same time you happen to be auditing the books of John Doe, have already learned of this endorsement and propose to show it in a footnote on his balance-sheet as a contingent liability, with his knowledge and consent, though he "thinks" it has been paid.

Bearing in mind that, under the laws of the state in which this transaction occurs, John Doe is now discharged as endorser, how

will you handle this matter in order to show it correctly on the respective balance-sheets?

(*American Institute of Accountants, May, 1930*)

Inventories

38. Explain the following terms as applied to merchandise inventories:

(*a*) Retail method.
(*b*) Normal or basic stock.
(*c*) Cost or market, whichever is lower.
(*d*) Lot method.
(*e*) Average cost.

(*Wisconsin, November, 1937*)

39. Describe briefly the essential requirements and the principal advantages of an adequate internal control of inventories; also discuss the importance of costing sales in relation thereto and describe two general methods of costing.

(*American Institute of Accountants, November, 1936*)

40. A manufacturer includes warehousing as part of the cost of goods manufactured. Because sales fell far short of expectation, a large portion of goods finished this year remains in warehouses located in different parts of the world. What disposition would you make of the expense of storing this abnormal finished-goods inventory?

(*Ohio, November, 1936*)

41. Company A has closed its books for the year with inventories as follows:

Finished goods	$450,000
In process	30,000
Raw materials	110,000

Your audit discloses that finished goods on consignment, amounting to $750 have been omitted from the inventory. (*a*) What adjustment should you make for this error? The treasurer of the company has requested that for convenience you overlook the error, since the records are closed. (*b*) What consideration can you give him?

(*Ohio, May, 1934*)

42. In preparing your work sheet at the close of the year, how should you treat the following invoices, dated December 28, for raw material shipped to your client but not received?

(*a*) Invoice for $25,000; terms 30 days net; f. o. b. destination.

(*b*) Invoice for $10,000; terms 2/10 days; 30 days net; f. o. b. point of origin.

(Ohio, November, 1934)

43. A client of yours asks information about the retail method of inventorying: (a) what it is, (b) what advantages it has over his present custom of inventorying at cost or market and (c) if it will facilitate income-tax returns.

What information would you give concerning the three questions asked?

(American Institute of Accountants, November, 1936)

44. (*a*) State the amount of the inventory for balance-sheet purposes, using the following data and applying the retail method.

Opening inventory at cost	$ 42,000
Purchases at cost	183,000
Transfers in at cost	20,000
Opening inventory at selling price	67,000
Actual sales at selling price	305,000
Markups	12,000
Markdowns	51,000
Purchases at selling price	285,000
Transfers in at selling price	30,000

(*b*) Submit in condensed profit and loss statement form, a method of accounting that will clearly show the effect upon profits of a severe market decline in inventory as distinct from other profit and loss factors.

(Wisconsin, November, 1937)

45. A summary of entries in the inventory account of a department in a retail store for the month of October was as shown at the top of page 492.

You are called upon to compute the book inventory at cost at October 31. Cost is to be estimated invoice cost plus freight of 5 per cent; cost of sales for the month is to be determined by subtracting from sales plus net markdowns an average markup

Inventory at retail October 1, 1936 (163.93443 % of cost, "cost" consisting of invoice cost, freight estimated at 5 % and a loading charge of 7 %)	$237,460.72	
Purchases, October, at invoice cost	87,576.17	
Freight	3,984.13	
Loading charge	6,130.33	
Markup on purchases	65,127.09	
Markdowns		$ 13,862.10
Cancellations of markdowns	5,783.42	
Net sales, October		122,562 18

as at the end of the month computed on the basis of total merchandise handled, i. e., without reference to sales or markdown adjustments made during the month.

(*Pennsylvania, November, 1937*)

46. There has been considerable recent discussion of the base, or minimum-stock, method of inventory valuation. Describe the operation of this method, and state its advantages and disadvantages.

(*Ohio, May, 1937*)

47. (*a*) The Lengthy Process Manufacturing Corporation has an inventory of $687,524 of which $361,408 is in the form of raw material which will require two to three years of "seasoning" before it can be used in the manufacture of finished goods. The quantity of this material involved is normal, but because of a decline in market price the amount is considerably less than in former years.

The following statements illustrate this situation:

Normal quantity at normal cost price	$492,776
Normal quantity at actual cost	361,408
Normal quantity at present market	312,789

Three questions are raised for your consideration:

1. Under what classification should this item be listed in the balance-sheet?

2. What valuation should be used in the balance-sheet?

3. What value should be used in the profit and loss statement?

(*b*) State the basis for evaluation of the following items in the inventory:

1. Salesmen's samples returned to stock.
2. Parts for discontinued models.
3. Shopworn merchandise.
4. Finished goods not yet shipped but made on contract.
5. Material purchased subject to rebate if specified quantity is bought within a fiscal year differing from closing date. It is impossible at date of balance sheet to determine whether the discount will be earned or not.

(*Wisconsin, May, 1932*)

48. The total amount of the inventory of merchandise of a trading concern has been increasing each year for the last three years while the gross profits have been diminishing.

(a) State the probable reasons for this; and

(b) How you would proceed to discover the real cause?

(*American Institute of Accountants, May, 1934*)

49. Part of the inventory of the E Company at June 30, 1935, was also on hand at June 30, 1934. On the latter date the cost was reduced to market; but during the year following, the market price rose to a figure exceeding original cost. The company has restored original cost in the June 30, 1935, inventory. Give reasons for or against this procedure.

(*Wisconsin, November, 1935*)

50. A smelting company credits gross income with the current market values of metals recovered from the refining of ores. This credit is made upon the date recovery is completed. When sales of the refined ores are made, the variation between the sales price and market at the date production was completed is credited or charged to an account known as "reserve for inventory variation." At the company's balance-sheet date the reserve had a credit balance exceeding $4,000,000. One company official takes the position that the reserve is a valuation account and should be deducted on the balance-sheet from the inventory. Another regards the reserve as a part of earned surplus. Another states that it is in the nature of a general reserve available for absorbing inventory and other losses in the future. What, in your opinion, is the reserve, and how should you classify it on the balance-sheet?

(*Wisconsin, November, 1936*)

51. Upon the examination of the sales records of a retail dress establishment you find the following conditions:

The inventory is kept on a perpetual inventory basis, purchases being charged at cost to inventory account and the dresses sold being credited to inventory at cost and charged to cost of sales. Numerous special orders are taken each month for dresses not carried in stock, and these are put through the records as regular sales.

At December 31, 1929, the following "special orders" were still unfilled:

Date	Sales price	Cost price	Cash deposit
December 4, 1929	$75 00	$40 00	$ 5.00
December 5, 1929	47.50	31.50	10 00
December 18, 1929	37.50	22.50	None
December 26, 1929	60.00	42 50	None

Cash deposits were credited to accounts receivable when the dresses were ordered. The liability is to be set up when the dresses are actually received from the wholesaler.

What effect would these items have on the financial statements at December 31, 1929, and what adjustments, if any, should you feel obliged to make?

(*District of Columbia, May, 1930*)

52. A manufacturer of refrigerators had 4,000 units of a 1933 model on hand at December 31, 1934. In February, 1935, prior to the completion of your audit, these units were disposed of as a job lot for $50,000. Their original cost had been $310,000 and their inventory value at December 31, 1933, was $248,000.

Assuming that the offer had been under consideration prior to December 31, 1934, what would be your opinion of the contention that, since no fair market value existed at the end of the year, the original cost of $310,000 should be restored as the inventory value? Would your conclusion concerning the proper valuation in the balance-sheet of December 31, 1934, be modified if the offer had not been received until February?

(*American Institute of Accountants, November, 1935*)

53. In your audit of the books of the Gable Sales Company, dealer in automobiles, you find on hand 14 used cars, acquired in trades, having a total book value of $4,800. The book value

represents the trade-in values at which the used cars were acquired. The cost up to the end of the fiscal period of putting the 14 cars in salable condition was $643.19, which has been charged to expense; and, in addition, it is estimated that approximately $550 will be required to complete the overhauling before they can be sold. Not more than $3,500 is, however, expected from the ultimate sale of these cars, and you are informed that the experience of the dealer has been fairly uniform in this respect. A commission of a flat 10 per cent is allowed salesmen on all used-car sales.

How should you express these items in your report to the company?

(*District of Columbia, May, 1932*)

54. In May, 1936, a grain dealer bought 100,000 bushels of wheat for delivery between July 1st and December 31st at $1.05 a bushel. How should the item be treated on the June 30, 1936, balance-sheet

(a) if the market had risen to $1.25 a bushel?

(b) if the market had fallen to $.85 a bushel?

Give reasons.

(*American Institute of Accountants, November, 1936*)

Investments

55. An investment company owns bonds of industrial corporations which it has purchased at different times at market. They are carried at cost and adjusted monthly on a pro-rata basis so that at maturity their book value will be the redemption price. What is this method of adjustment called, and how should you designate the method of valuation on the balance-sheet?

(*Wisconsin, November, 1936*)

56. A certain company has deposited with a sinking-fund trustee $10,000 representing an instalment on an interest maturity several months hence. Accrued interest payable of the same amount has been accumulated on the books. How should these items appear on the company's balance-sheet?

(*Wisconsin, November, 1935*)

57. What disclosure, if any, on a balance-sheet should you recommend when the corporation has failed to deposit before

the end of the year the usual sinking-fund instalment with a debenture trustee?

(*District of Columbia, May, 1936*)

58. How should you disclose on a balance-sheet dated December 31, 1935, the possession of debentures purchased by the company in anticipation of a sinking-fund instalment due January 2, 1936?

(*District of Columbia, May, 1936*)

59. The sinking-fund trustee is holding alive in the sinking fund some of the company's own bonds, subject to resale or cancellation at any time by his decision. You are asked to give your opinion, first, on the advisability of holding these bonds and, second, as to the method of recording the payment of interest on these bonds. Include in your answer the journal entries on the books of both the company and the trustee when interest is paid on bonds held by the trustee.

(*Ohio, May, 1932*)

60. You are invited to address a regional bankers' convention on the subject of internal check in handling loans and discounts. Give an outline of what you would suggest.

(*American Institute of Accountants, November, 1932*)

61. You are asked to prepare a statement as of December 31, 1931, for a company that deals in second mortgages. The company started operations January 1, 1931. Their records reflected the following information relative to the purchases of second mortgages:

Date of purchase	Term of mortgage	Face value	Cost
January 1, 1931	1 year	$25,000	$22,000
January 1, 1931	2 year	37,500	35,000
July 1, 1931	2 year	25,000	20,000
July 1, 1931	4 year	15,000	11,000
July 1, 1931	5 year	10,000	10,000

The mortgages were payable in equal semi-annual instalments, and payments were made when due. The discount on the mortgages had been credited direct to profit and loss, and the face value of the mortgages had been set up as a receivable.

(*a*) Are any adjustments to the records required before you can prepare a statement? If adjustments are necessary, give the necessary journal entries and your reasons for making them. (*b*) If no adjustments are necessary, give your reasons.

(*Wisconsin, May, 1932*)

Fixed Assets

62. Distinguish between capital and revenue as applied to accounting.

Designate which of these terms would apply to the following:

(*a*) Cost of new machinery purchased.
(*b*) Cost of installing new machinery.
(*c*) Cost of machinery replacements.
(*d*) Cost of acquiring patents.
(*e*) Cost of patterns and dies.
(*f*) Discount on an original bond issue.
(*g*) Discount on bonds purchased for retirement.
(*h*) Tooling expense incident to bringing out a new product.

(*Ohio, May, 1934*)

63. Your client requested your opinion regarding a contemplated change in equipment to speed up production. The following information was submitted for your consideration:

A machine having an annual capacity of 100,000 units cost $27,000 twelve years ago, at which time the estimated life was fifteen years, without salvage value. It requires three employees to operate the machine at an annual salary of $1,200 each. A new machine having an annual capacity of 150,000 units can be purchased for $20,000 with a trade-in allowance of $1,400 for the old machine. The new machine, which has an estimated life of ten years, without salvage value, requires one operator at an annual salary of $2,000. By using the straight-line method of depreciation and assuming other expenses to be equal, write a brief report showing how you determined the total net saving or the total net loss that would result from the exchange.

(*Ohio, November, 1934*)

64. Under what conditions should you pass additions to fixed assets in the form of overhead charges on construction work undertaken by the company whose accounts you are examining?

(*District of Columbia, May, 1936*)

65. A large machine of a manufacturing company has broken down, and the management decides to rebuild it. To do so involves a considerable expenditure for tearing down the present machine, repairing and overhauling certain parts and reconstruction. Where should you charge the various costs? Discuss the principle.

(*Wisconsin, November, 1934*)

66. Discuss the accounting procedure for recording the loss from dismantling a large portion of plant and equipment due to the abandonment of an entire important process of manufacture, and cost of rebuilding and acquiring new equipment for the processing of a different product.

(*Ohio, October, 1937*)

67. An asset is usually defined as property owned. How should you treat, on a balance-sheet of a railroad, rolling stock purchased by means of equipment trust certificates where the title remains with the trustee until the last certificate is redeemed?

(*Ohio, November, 1936*)

68. What do you understand by the retirement basis of accounting as applied to fixed capital investment, particularly of public utility companies? Do you approve of such basis? State your reasons.

(*Ohio, May, 1934*)

69. The new A Corporation purchased a plant for $50,000. The plant, which has been idle for four years, has been appraised at $400,000, and $25,000 has been expended to recondition it. You have been asked your opinion as to what amount might be borrowed on a first mortgage. What other information should you desire, and what method should you use to determine the amount suggested?

(*Ohio, May, 1935*)

70. (*a*) For three years the Evasion Company has charged to the machinery repairs account items that should have been charged to the machinery and equipment account. It is agreed that 5 per cent is the correct rate of depreciation and that assets are to be depreciated for one-half (½) year in the year of acquisition. Items incorrectly charged to the machinery repairs account are as follows:

1934	$6,000
1935	7,500
1936	8,000

Submit one compound journal entry to correct the records as of December 31, 1936, assuming that the 1936 depreciation has been recorded but that the books have not yet been closed.

(*b*) What treatment should you give the undepreciated balance of fixed assets in good condition but discarded because of supersession, obsolescence or inadequacy?

(*c*) How should you journalize depreciation on appreciated values recorded as the result of an independent appraisal?

(*Wisconsin, November, 1937*)

71. It was the policy of the U. N. Wise Corporation to charge all of its fixed assets into one account called plant and equipment and to credit depreciation at a composite rate of 5 per cent on the opening annual balance to a single reserve for depreciation account. In many instances replacements were improperly handled. After following this procedure for five years, because of a change in management, it was decided to discontinue this practice and segregate the various classes of assets into separate accounts with corresponding reserves. As a result of extensive analysis, the plant and equipment account was broken up into its elements as follows:

	Asset	Reserve
Land	$18,000	
Buildings	75,000	$5,625
Machinery (see note)	64,897	
Automobile trucks	14,250	4,180
Factory equipment	32,173	9,716
Office furniture	11,781	4,238

NOTE.—In checking the depreciation schedules, you discover that the work was properly performed, with the exceptions of the machinery account, where because of a misunderstanding of instructions the rate used was incorrect. It is therefore necessary to recompute the depreciation from 1927 to 1931 inclusive at the rate of 5 per cent per annum based on the following amounts:

1927—$43,614 opening balance (full year's depreciation)
1928— 8,267 additions
1929— 3,500 additions
1930— 7,216 additions
1931— 2,300 additions

Additions are to be depreciated at one-half the normal rate for the first year.

The plant and equipment account on December 31, 1931, shows a balance of $238,764; and the reserve account, $54,020.

Required:

A single journal entry to set the detailed accounts and their respective reserves upon the books in place of the preceding account.

(*Wisconsin, May, 1932*)

72. Among the equipment accounts of B Foundry Company is one entitled "patterns." Analysis of this account discloses the fact that on January 1, 1925, when the corporation was formed and the assets purchased from a going company, a value was set up of $145,000, less accrued depreciation of $23,557.30, based on appraisal figures which determined the purchase price. Since that time no further provision has been made for depreciation, and all additions have been charged directly to expense as follows:

Year	Purchases charged to expense
1925	$114,024.80
1926	75,649 36
1927	120,298.28
1928	102,236.44
1929	60,845.12

The management believes the continued appearance of the same value for patterns impairs the worth of the balance-sheet in the eyes of bankers. It is also pointed out that because the charges for patterns vary so much from year to year, the present policy is inequitable in the determination of operating results. The management asks you if it is possible to establish this asset on a uniform depreciation basis that will leave the net value of the asset unchanged from the book value of December 31, 1929.

The superintendent informs you that the average life of his patterns is in the neighborhood of four years. Draw up a schedule, and outline your opinion on making such a change together with other pertinent information which you believe should be called to the attention of the management.

(*Ohio, May, 1932*)

73. Your advice has been sought by a client on the desirability of eliminating a large portion of his fixed asset accounts for the purpose of relieving future income of heavy depreciation charges. How should you answer him?

(*District of Columbia, May, 1936*)

74. In the course of your audit of the X Machine Corporation for the year 1933 you discover that the plant account has been written down one-half its book value by the journal entry—

"Dec. 31, 1933.	Reserve for depreciation............	$......	
	To plant account......................		$......"

You learn that this was authorized by the board of directors, and you are shown a draft of the proposed report to stockholders in which it is recited that the amount represents the net book value, as of January 1, 1933, of plant and equipment which was idle during the entire year; that its purpose is to show the investment in plant at a conservative figure in accord with general conditions due to the depression; that its effect is to confine the annual depreciation charge to plant actually engaged in production during the year; and that the profit-and-loss statement thus shows the true profit made on actual production and sales. It is further intimated in somewhat guarded language that when and as business improves and the idle plant resumes normal production, the value now charged off will be restored to plant account.

State whether or not you will approve this procedure by certifying the corporation's statements, and give your reasons in full.

(*American Institute of Accountants, November, 1934*)

75. With respect to a machine, what relationship exists between depreciation accruing thereon for accounting purposes and the decline in its efficiency?

(*Wisconsin, November, 1935*)

76. State four causes for depreciation. What are the factors determining the amount of depreciation to be written off periodically?

(*Ohio, May, 1936*)

77. State on what basis you would provide for depreciation or obsolescence of the following classes of property: (*a*) machinery, (*b*) small tools, (*c*) patterns, (*d*) oil-well equipment, (*e*) coal mine, (*f*) electric power plant, (*g*) telephone cables, (*h*) municipal buildings.

(*Ohio, May, 1935*)

78. During the course of an audit of the A Corporation, you found that no provision had been made for depreciation on the books. Discussing this matter with you, the treasurer of the company made the following statement:

"Depreciation has been offset by an increase in the market value of the plant. The policy of the company has been to maintain the plant and equipment in an excellent state of repair. For these reasons, it is good business not to burden operations with depreciation, because the money is needed for working capital."

Give your views regarding this statement. You found that the treasurer was correct in that the plant and equipment were well maintained; state how you treated this matter in your report.

(*Ohio, May, 1933*)

79. Following is an analysis of the automobile and reserve for depreciation accounts of the X Corporation:

AUTOMOBILE ACCOUNT

		Debits	
January	1, 1925.	4 trucks at $2,000 each	$ 8,000
July	1, 1925.	1 truck at $1,800	1,800
July	1, 1926.	1 truck at $2,500 less allowance on truck purchased January 1, 1925	1,400
September	1, 1926.	2 trucks at $1,500	3,000
July	1, 1928.	3 trucks at $2,000 each	6,000
January	1, 1929.	1 truck at $2,100 less allowance on truck purchased January 1, 1925	1,800
		Total	$22,000
		Credits	
July	1, 1928.	1 truck sold (purchased January 1, 1925)	$ 400
December	31, 1929.	Trucks purchased during 1925 fully depreciated	9,800
		Total	$10,200
		Debit balance	$11,800

RESERVE FOR DEPRECIATION—AUTOMOBILES

	Credits	
December 31, 1925.	Depreciation 1925	$ 1,225
December 31, 1926.	Depreciation 1926	3,000
December 31, 1927.	Depreciation 1927	3,550
December 31, 1928.	Depreciation 1928	4,250
December 31, 1929.	Depreciation 1929	3,950
	Total	$15,975
	Debits	
December 31, 1929.	Trucks purchased during 1925 fully depreciated	9,800
	Credit balance, December 31, 1929.	$ 6,175

The company has adopted a policy of depreciating automobiles at the annual rate of 25 per cent on opening balances and 12½ per cent on all net additions. The credit of $400 to automobile account on July 1, 1928, was the cash received.

Assuming that the depreciation rates are correct, what criticism, if any, have you to make of the company's method of handling these two accounts? If you feel that the accounts need adjustment, submit your adjusting journal entries.

(*Ohio, May, 1932*)

80. The accounts of a state university contain no reserves for depreciation, although full costs of all buildings and equipment appear on the records. Do you believe that depreciation reserves should be maintained? If so, how should you dispose of the annual provisions for depreciation?

(*District of Columbia, May, 1933*)

81. The Y Company has written up its fixed assets to replacement values and proposes to use these values for balance-sheet purposes. How should you treat depreciation on the company books and financial statements? Give reasons.

(*Wisconsin, November, 1934*)

Liabilities

82. Where you find no voucher system or purchase journal in which purchases can be recorded as incurred, what precautions should you take to make sure that all liabilities have been recorded?

(*District of Columbia, May, 1931*)

83. (a) State how a straight voucher system is used, recorded and controlled.

(b) May it be used in conjunction with an accounts-payable ledger, and in what way?

(c) Under what conditions is it preferable in conjunction with an accounts-payable ledger?

(*American Institute of Accountants, November, 1934*)

84. In the accounts-payable item on the balance-sheet accountants rarely segregate those past due. Do you think this should be done? Give your reasons, pro and con.

(*American Institute of Accountants, November, 1935*)

85. In listing the balances from creditors' ledger (assumed to be in agreement with controlling account) you find several debit balances. State

(a) three causes which may account for these balances;

(b) how you would treat cases arising from each cause.

(*American Institute of Accountants, May, 1931*)

86. A certain corporation pays quarterly dividends in cash or in no-par-value common stock at the option of the shareholder. How should you set forth on a balance-sheet the obligation for such a dividend, and in what amount?

(*Wisconsin, November, 1935*)

87. Are the following items liabilities at December 31, 1929? If so, how should they be classified?

(*a*) Purchase money obligation on machinery recently acquired maturing in ten semi-annual instalments with interest payable on each instalment in full only at maturity of instalment.

(*b*) Cash dividend of $80,000 declared January 2, 1930, payable the following day.

(*c*) Local real estate taxes assessed in February, 1930, and payable in April, 1930.

(*d*) Subdealer's note discounted, secured by merchandise sold to him; ability of subdealer to pay doubtful.

(*e*) Merchandise held in warehouse, title not transferred, to be withdrawn and paid for as, if and when sales of that particular product are made. Notes have been given covering payment

which will be canceled and returned at the end of six months for such goods as remain unsold at that time.

(*District of Columbia, May, 1930*)

88. A merchandising firm at the time of each sale distributes coupons which are exchangeable for additional merchandise. What treatment should be accorded this policy in a balance-sheet and income and expense statement that you are about to issue? Would your answer be the same if the premium merchandise is a product of the same company, and (*a*) used wholly for premium purposes or (*b*) only a minor portion of production being used for such purposes?

(*Ohio, May, 1936*)

89. A bank engages you to audit the accounts of the Smith Manufacturing Company, which is seeking a loan. You find that the company is not incorporated and that A. B. Smith is the sole owner of the business.

How far will you go in determining and setting out in your report the personal assets and liabilities of Mr. Smith? State your procedure.

(*American Institute of Accountants, November, 1932*)

90. In 1929 T Company purchased a large factory building and, to finance the deal, executed a purchase-money mortgage of $100,000 payable in 10 years. In 1933 it sold the property to U Company which deducted from the sales price of $150,000 the amount due on the purchase-money mortgage of $100,000.

In the course of your examination of the books of T Company for the year ended December 31, 1934, you find a journal entry recording the sale of the property.

How should the realty transaction be shown on the balance-sheet, assuming that there is a marked deflation in realty values and that the U Company was declared bankrupt on December 1, 1934?

(*American Institute of Accountants, November, 1934*)

91. The M Corporation purchased its own bonds on the market at a discount. There is on the books of account unamortized bond discount. (*a*) What journal entries should be made

at date of purchase? (*b*) Provided the same bonds are resold at a further discount, what journal entries should be made?

(*Ohio, November, 1933*)

92. Distinguish among the following types of bonds:

(*a*) First-mortgage bonds.
(*b*) Convertible bonds.
(*c*) Serial bonds.
(*d*) Collateral trust bonds.
(*e*) Guaranteed bonds.
(*f*) Fidelity bonds.

(*Ohio, October, 1937*)

93. The balance-sheet of the A Corporation shows as a fixed liability "First mortgage bonds, $100,000." On inquiry you learn that these bonds mature within the next six months, and you inform the treasurer that you propose to show the item as a current liability. He explains that steps are being taken to refund the liability by a new issue of bonds at a lower rate of interest. From a survey of the finances of the corporation you are convinced that it will have no other means of meeting the debt.

It so happens that another client of yours owns 90% of the bonds, and has boasted to you that he will soon obtain full possession of the A Corporation which is a business rival.

(a) What use will you make of this knowledge?
(b) How will you treat this item on the A Corporation balance-sheet? Give your reasons.

(*American Institute of Accountants, May, 1936*)

94. A client's books as at December 31, 1931, disclosed a credit balance in bonds payable account of $87,500. An analysis of the account disclosed the following: (*a*) par value, ten-year bonds dated January 1, 1929, authorized, $250,000; (*b*) $150,000 sold January 1, 1930, at 10 per cent discount and (*c*) $50,000 repurchased at 95, July 1, 1931.

What adjusting entries should you make?

(*Ohio, May, 1932*)

95. A, B, and C are the officers and directors and the owners of 55 per cent of the outstanding capital stock of the Cyril

Building Corporation, the remaining stockholders being inactive in the company's affairs. In September, 1931, A, B, and C employed an individual to purchase corporate obligations (first-mortgage bonds) in the amount of $70,000, maturing October 15, 1931, at as great a discount as the bondholders could be induced to accept. Cash loans equal to the par value of the maturing bonds were made by the corporation to the three individuals in order that the purchases might be made, and at maturity the bonds, which had been purchased at an average price of 60, were formally redeemed by the corporation, and the loans to the individuals canceled.

What would be your attitude, as auditor, as to these transactions in the preparation of a certified balance-sheet of the Cyril Building Corporation at December 31, 1931? You were appointed auditor by the stockholders at a special meeting held on May 2, 1932.

(District of Columbia, May, 1932)

96. During the course of an audit as at December 31, 1931, you find that your client in 1925 purchased two acres of land adjacent to its present plant for future expansion, subject to a first mortgage, the maturity of which was May 10, 1929. The mortgage has not been refinanced but has been extended for one year at each May 10 since 1929, the date of the annual 6 per cent interest payment. The bank that owns the mortgage informs you that, subject to the usual interest payment at May 10, 1932, it will grant the customary one-year extension of the mortgage to May 10, 1933. Your client is in good financial position. How shall you show the mortgage liability on the balance-sheet?

(District of Columbia, May, 1932)

97. The A Corporation had an issue of $500,000 first-mortgage serial bonds outstanding at the beginning of its fiscal year. During the current year, it purchased $100,000 of the bonds at 75. How should this transaction be recorded? Is the $25,000 saving available for dividends? If there were unamortized bond discount on the books, what disposition, if any, should be made of that portion applying to the bonds purchased?

(Ohio, May, 1936)

98. On January 1, 1930, the V Company issued $1,000,000 bonds at 95. In terms of the issue $200,000 are to be retired on January 1, 1933, and $500,000 by annual amounts of $100,000 on January 1st of each of the five years next succeeding, the balance of $300,000 to be retired on January 1, 1939. Prepare a table showing the amortization of the discount by the bonds-outstanding method.

(*American Institute of Accountants, November, 1934*)

99. On July 1, 1927, a company issued $1,000,000 in bonds at a discount of 10%. These bonds were to mature as follows:

July 1, 1932	$ 100,000
" 1933	100,000
" 1934	100,000
" 1935	100,000
" 1936	100,000
" 1937	500,000
Total	$1,000,000

On July 1, 1935, the company purchased $50,000 (par value) of bonds maturing on July 1, 1936, at 85 and retired them.

What entry should be made on July 1, 1935, to record the purchase?

(The solution should be based on the "bonds outstanding method.")

(*American Institute of Accountants, May, 1936*)

100. A company with a capital of $25,000,000 contracted for the construction of a new building at its factory. This contract was formally authorized and accepted by the board of directors. Construction commenced in October, 1934, and at December 31, 1934, the engineers estimated that in addition to the payments already made to the contractors, $2,500,000 was necessary to complete the building.

What disclosure do you deem necessary on the December 31, 1934, balance-sheet—

1. If the company's cash balance is adequate and no new financing is intended and
   (a) in case the amount has been formally appropriated.
   (b) when not definitely appropriated.

2. If arrangements had been completed early in January, 1935, to raise the $2,500,000 through an issue of bonds.

(*American Institute of Accountants, November, 1935*)

101. In what way may contingent liabilities exist with respect to the following items:

(*a*) Notes receivable discounted.
(*b*) Unfulfilled contracts.
(*c*) Mortgage on land, the land having been sold.

(*District of Columbia, May, 1936*)

102. A corporation, in the ordinary course of business, contracted for the purchase of raw materials for future deliveries. In the preparation of a balance-sheet should you take cognizance of these commitments? If advance payments were made on the contracts, how should you treat this matter?

(*Ohio, May, 1936*)

103. If inventory declines in value between the date of statement and that of certification, and the concern audited has a potential loss on purchase commitments what is the responsibility of the auditor to indicate the loss as of certification date?

(*American Institute of Accountants, May, 1934*)

104. The Midwest Gas and Electric Company has a one-year agreement beginning January 1, 1934, with the Strikeless Coal Company whereby it agrees to buy all its coal requirements at cost plus 10 per cent, which is to be determined quarterly. The agreement stipulates that the minimum amount of purchases during the calendar year shall not be less than $1,500,000.

At September 30, 1934, the total purchased and consumed to date is $900,000. What notes, if any, do you think should accompany the balance-sheet of the utility company at September 30, 1934, with respect to the foregoing items?

(*Wisconsin, November, 1934*)

Net Worth

105. What disposition should be made of a premium (over par) received by a company on the sale of its common capital stock?

(*District of Columbia, November, 1936*)

106. (*a*) Explain the proper treatment in a balance-sheet of capital stock without par value, represented by Class A shares issued for a consideration of $10 a share and callable out of earnings at $30 a share, and having priority over Class B shares in dividends of $2 annually, Class B shares having equal voting rights with Class A and having been sold at $5 a share.

(*b*) What entries should be made from time to time when Class A shares are called?

(*Ohio, May, 1931*)

107. Make journal entries to show the following transactions. (*a*) January 1—sale of 10 shares of common stock, $100 par value, to each of X, Y and Z, 20 per cent cash at time of sale and balance in equal instalments, March 1 and May 1. (*b*) March 1—payment of instalment due by X and Y. (*c*) May 1—payment of final instalment by X and Y and issue of their stock. (*d*) June 1—Z, after ignoring the two instalments, refuses to make further payment and forfeits his initial payment.

(*Ohio, November, 1933*)

108. During 1935 the stockholders of the A Company authorized that 10,000 shares of unissued capital stock be reserved for sale to officers over a period of years at a price equal to market less 20 per cent. In accordance with this understanding the officers purchased 1,000 shares before the end of the year at $32 a share. How should the company's balance-sheet reflect these facts?

(*District of Columbia, May, 1936*)

109. (a) What is a "stock right," and how is it declared?

(b) Give the formula for ascertaining the theoretical value of a "right" as attaching to each old share, explaining the meaning of your symbols.

(c) Give an example in actual figures.

(*American Institute of Accountants, November, 1933*)

110. On December 26, 1930, the L Company issued rights to its stockholders permitting the owner of 10 shares of common to subscribe at $90 to one share of 7 per cent cumulative preferred on or before April 1, 1931, payment to be made April 15, 1931. Prior to the close of 1930, 55 shares had been subscribed through the exercise of rights, and at the date of your audit (in March,

1931) 322 additional shares had been subscribed. Should any of these facts be given expression on the balance-sheet of December 31, 1930?

(*District of Columbia, May, 1931*)

111. The original stockholders of The A Manufacturing Company sold their stock to B and associates for $200,000, taking notes secured by a chattel mortgage on all machinery owned by The A Manufacturing Company. The agreement of sale specifies that the stock sold shall be held as treasury stock by the company until B and associates have paid the notes, at which time new stock shall be issued and the treasury stock canceled. (*a*) What journal entries should be made on the books of The A Manufacturing Company? (*b*) How will the treasury stock be shown on the balance-sheet of The A Manufacturing Company?

(*Ohio, November, 1933*)

112. Under the Delaware corporation law, capital stock may be repurchased by a company "from surplus." Presumably surplus so applied is no longer available for dividends. How should you indicate this fact on the balance-sheet of a Delaware corporation that has reacquired a portion of its common stock at a cost equal to the sum of its capital surplus and earned surplus?

(*District of Columbia, May, 1933*)

113. A company has purchased 10,000 shares of its own $100 par stock at $95 per share. The balance-sheet submitted to you includes the purchase as an investment of $1,000,000, further classified as "treasury stock"; and the profit and loss statement includes as profit $50,000 from purchase of this stock. Has this transaction been handled correctly? Give reasons, and state what adjustments, if any, you would suggest.

(*Ohio, May, 1934*)

114. On what theory might a corporation owning treasury stock that it has purchased in the open market credit its income account with the dividends declared on such stock? Do you accept such theory? Give reasons.

(*Ohio, May, 1934*)

115. In 1925 your client, a corporation, issued 100,000 shares of cumulative preferred stock. In 1927 it repurchased 20,000 of these shares and held them as treasury stock until 1932 when it sold them at cost. Dividends for 1930 and 1931 on the preferred stock were suspended, but were declared in 1932 together with the dividend for that year.

You find that the dividends on the 20,000 shares of treasury stock for 1928 and 1929 were entered on the books as income to the corporation, as were also the suspended dividends when declared in 1932, the purchasers of record of these shares receiving only the dividend for 1932.

How will you deal with this matter? Give your reasons.

(*American Institute of Accountants, November, 1932*)

116. The A Company, whose stock is listed on the exchange, has purchased about 5 per cent of its outstanding stock at current market price (which is nearly three times the original issue price) for distribution to employees under a certain bonus plan. It is estimated that not more than 20 per cent of the present holdings will be distributed during the coming year. It has been the practice of the company on its balance-sheet to regard the investment as an asset and on its statement of profit and loss to include dividends received therefrom as miscellaneous income. Do you approve? If not, how should you dispose of these items?

(*District of Columbia, May, 1930*)

117. At December 31, 1935, the dividends in arrears on the three classes of $100-par preferred stock of X Company amounted to $6,049,171, as follows:

Class of preferred	Outstanding shares	Dividends in arrears
5¼%	924	$15.375
6	169,076	17.625
8 (callable at 110)	130,000	23.50

As at April 1, 1936, all preferred stockholders agreed to exchange their holdings at par plus their claims on dividends and premium to date for a new issue of 5 per cent $100-par preferred stock of one class which is to be listed at once on the exchange. It was further agreed that they accept the new stock at par for the par of their old holdings plus the amount of their

claims to the even dollar thereof and cash for their claims of less than one dollar.

Prepare a journal entry to record the recapitalization.

How should the company advise its stockholders to report the exchange for federal income-tax purposes?

(*District of Columbia, May, 1936*)

118. (*a*) Describe six sources of surplus, and classify them as between earned and the various forms of capital surplus. From a financial standpoint (as opposed to the legal), which are available for cash dividends?

(*b*) What recognition should be given on the face of a balance-sheet to dividends in arrears on 7 per cent cumulative preferred stock?

(*District of Columbia, May, 1931*)

119. How is paid-in surplus created? What is your objection to paying dividends to preferred stockholders from paid-in surplus? When a corporation, if the state permits, purchases its own shares to hold for resale, what record is made in the balance-sheet for these shares? What conditions, other than a state law, would prevent the purchase of its own stock? How are dividends earned on these shares held for resale handled on the books?

(*Ohio, May, 1935*)

120. A corporation carries upon its books accounts designated "capital surplus" and "surplus from revaluation of plant assets." What character of charges could properly be made to each of such accounts?

(*Ohio, May, 1937*)

121. In the earned-surplus account of the C Company you find that during the year 1930 the following debits had been made:

Damages paid in settlement of suit on patent infringement covering period of 5 years......	$125,265.00
Unabsorbed factory overhead due to plant shutdown for 3 months, reduced floor space occupied and experimental expense on prospective new product..........................	45,872.61
Loss from replacement of defective parts on machines marketed in 1929............ .. .	28,666.03
Total surplus debits.....	$199,803.64

The president of the company has asked you to omit these deductions from your statement of profit and loss owing to the small profit for the year and because preliminary reports of profits have already been sent out to stockholders. What would be your attitude?

(*District of Columbia, May, 1931*)

122. You are called upon to determine whether the following items appearing in the accounts of the Y Chain Stores, Inc., for 1931, should be charged to current operations, to earned surplus or to the various forms of capital surplus:

(*a*) Unamortized portion of bond discount and expense in connection with retirement during the year of funded debt.

(*b*) Provision for probable decline in value of investments of subsidiary companies.

(*c*) Provision for reserve for rent losses on stores of chains purchased and since closed to avoid duplication.

(*d*) Write-down of inventory acquired during year due to market declines at end of year.

(*e*) Balance of preopening expenses of retail stores and mail-order plants, heretofore deferred.

(*f*) Provision for possible loss on foreign exchange.

(*g*) Net loss on sale of equipment.

(*h*) Reduction to par value of own stock held in treasury.

(*District of Columbia, May, 1932*)

123. The Standard Manufacturing Corporation sold 10,000 shares of preferred stock at 90 in 1936. The preferred stock is without par value, has a preference as to assets of $100 a share, and is convertible into common stock in the ratio of one share of preferred to two shares of common. The common stock has a par value of $20 a share.

The corporation has ample earned surplus, and by action of the board of directors in December, 1936, subsequently approved by the stockholders, $100,000 of earned surplus was appropriated to bring the preferred-capital-stock account up to the liquidating value of $100 a share.

During the year 1937 one thousand shares of preferred stock, recorded on the books at an aggregate value of $100,000, were converted into 2,000 shares of common stock, having an aggregate par value of $40,000.

A states that the difference of $60,000 should be credited to earned surplus as a partial restoration of the previous charge of $100,000. B says the credit should go to the capital surplus until such time as there is available the full amount of $100,000 for transfer to earned surplus. C says that the credit to earned surplus should be at the rate of $10 a share on the 1000 shares preferred that were converted into 2000 shares common, or $10,000, thereby reducing the $100,000 previously charged. Inasmuch as this is the first year conversions of preferred stock into common stock have taken place, it is desired to establish a definite policy for the future and for this purpose A, B, and C come to you for advice. What treatment would you recommend? Give reasons.

(*American Institute of Accountants, November, 1937*)

124. What is a "passed" dividend?

(*Wisconsin, November, 1936*)

125. Distinguish between a split-up and a stock dividend.

(*Wisconsin, November, 1936*)

126. Do you regard stock dividends as income to the recipient? How should they be recorded in the recipient's accounts, if at all? Disregard federal income-tax interpretations unless you consider them appropriate.

(*Wisconsin, November, 1936*)

127. The A corporation has passed the cumulative preferred dividends on its stock for the past two years. How should this condition be shown, if at all, in published statements? Give reasons for your answer.

(*American Institute of Accountants, May, 1932*)

128. The A Company, having $50,000 6 per cent preferred and $50,000 of $100 par value common, has made net profits as follows:

Year 1930	$2,500
Year 1931	6,000
Year 1932	8,000

The directors have declared all dividends possible each year, and you are asked to determine what the dividends of each class

would be if the preferred stock were: (*a*) noncumulative, (*b*) cumulative, (*c*) cumulative with further equal dividends after the common stock had received 6 per cent.

(*Ohio, May, 1934*)

129. The balance-sheet of a corporation at September 30, 1933, was as follows:

Assets		*Liabilities*	
Cash	$ 20,000	Notes and accounts payable	$140,000
Receivables	30,000	Reserve for depreciation	10,000
Inventories	80,000	Capital stock	100,000
Machinery 5 years old, estimated life 10 years	200,000	Surplus	80,000
Total	$330,000	Total	$330,000

There being sufficient cash to pay a dividend, the directors requested you to examine the preceding statement and, without making an audit, advise what rate they should declare. Draft an answer to this request.

(*Ohio, November, 1933*)

130. A corporation has been in business for many years and both business and plant facilities have been continually expanded. It has regularly made good profits and accumulated a large surplus which is shown without explanation on the balance-sheet as a single item.

At an annual meeting the stockholders complain that their dividends have not been commensurate with the prosperity of the corporation as shown by the annual statements, and the president explains vaguely that while most of the surplus is legally available for dividends, there are practical reasons why it can not be distributed at the present time. Not satisfied with this explanation the stockholders thereupon engage you to make an examination and analysis of the surplus account and report thereon.

Assuming that the president's explanation is correct, state what you would expect to discover and report.

(*American Institute of Accountants, November, 1935*)

131. The capital of M Company consists of 200 shares of $100-par-value cumulative preferred stock and 2,000 shares of no-par-

value common stock having a paid-in value of $200,000. All the preferred stock is owned by one of the larger creditors of the company. The common stock is owned by the president of the company except for three qualifying shares held by his relatives. Organized three years ago, the company has been operating at a small loss.

The president wished to pay a dividend on the preferred stock but because of the accumulated deficit has authorized the treasurer of the company to pay him, in addition to his salary, a commission on sales of $1,400, with which he personally paid the dividend.

What recognition should be made of this transaction on the financial statements of the company?

(District of Columbia, May, 1933)

132. While making an audit of the Van Dyne Company for the year ending December 31, 1930, you discover in the minutes of the board of directors dated January 2, 1930, a declaration of a 50 per cent stock dividend. No record of such dividend has been made on the books of the company, but reference to the stockbook reveals the fact that the new shares have been issued, and, according to the books, cash dividends of 6 per cent have been paid on the entire issue during the year. On December 31, 1930, the net-worth accounts before adjustment may be summarized as follows:

Capital stock—2,000 shares authorized, 1,000 shares issued prior to 1930; par value, $100.00 each		$100,000 00
Surplus—		
Arising from appraisal of equipment in 1928		76,500.00
Earned—		
Balance, January 1, 1930	$24,530.18	
Profit for the year ending December 31, 1930	17,589.26	
Total	$42,119.44	
Less—dividends paid	9,000.00	33,119.44
Total		$209,619.44

How should you reflect the action of the board of directors on the balance-sheet?

(District of Columbia, May, 1931)

133. The Puzzle Manufacturing Company presents the following balance-sheet on December 31, 1931, together with the other facts herein below stated.

Cash		$526,000
Notes and accounts receivable—net		254,000
Inventories		371,581
Fixed assets—net		930,251
Prepaid expenses		7,168
Total assets		$2,089,000
Notes and accounts payable	$218,000	
Bonds issued	500,000	
Accrued taxes, etc	21,000	
Total liabilities		739,000
Common stock ($100 par)	$750,000	
Surplus	600,000	
Total proprietary interest		$1,350,000

Net profit for 1931 after all deductions and provisions for taxes, etc., $162,800 included in the [illegible] surplus. Normal profits average $80,000 annually.

The directors are undecided as to whether they should declare a 10 per cent cash dividend or a 10 per cent stock dividend and have asked you to explain the immediate and the ultimate effect of each action so that they may act intelligently.

(*a*) Prepare on working paper, in comparative form, balance-sheets illustrating the immediate effects of each action.

(*b*) State the book value per share of stock in each case.

(*c*) State the long-time advantages and disadvantages of each plan.

(*Wisconsin, May, 1932*)

134. The liabilities, reserves and capital stated in the balance-sheet of a corporation at June 30, 1934, were as follows:

Total liabilities	$ 500,000
Reserve for bond sinking fund	25,000
Reserve for depreciation	35,000
Reserve for bad debts	15,000
Reserve for expansion of plant	300,000
Reserve for retirement of preferred stock	100,000
Preferred stock—2,000 shares 6 % cumulative par value $100—dividends in arrears since July 1, 1932	200,000

Common stock—5,000 shares, no par	$ 500,000
Revaluation surplus	100,000
Capital surplus	25,000
Deficit—in red	(300,000)
Total net worth	$1,500,000

What was the book value per share of the preferred and the common stock?

(*Ohio, November, 1934*)

135. Comment on the practice of reducing the amount of capital stock outstanding, thus creating a capital surplus, and then writing down the assets against such surplus. Assuming that the assets written down remain in the possession of the company and were previously carried at actual cost, indicate in your comments the immediate and the ultimate effect of such revision of capital structure.

(*Wisconsin, November, 1937*)

136. By means of a reduction during the year in the stated value of its common no-par stock, a company has absorbed a large deficit existing at the beginning of the year. A net profit results from the year's operations. How should you state these facts on your balance-sheet at the close of the year?

(*District of Columbia, May, 1936*)

137. An investment trust company of the management type maintains the following surplus accounts:

(*a*) Capital surplus; in this account are credited and debited gains and losses arising from the valuation of securities on hand at market prices at December 31 of each year. On December 31, 1931, the debit balance in this account was $42,346,655.18.

(*b*) Surplus from realized security gains; to this account are transferred gains or losses previously credited or debited to capital surplus with respect to investments sold, together with any further gain or loss resulting from movements of market values since the next previous December 31. On December 31, 1931, the debit balance in this account was $5,368,775.54.

(*c*) Earned surplus; to this account are credited interest and dividends received less administrative expenses and interest paid. The account is debited with cash dividends paid on preferred and common stocks, and in 1931 it was credited with the sum of $49,500,000 which arose from the reduction in the declared value

of the common stock outstanding from $27.50 a share to a par value of $5 a share. The credit balance of this account at December 31, 1931, was $1[illegible].

In the minutes of a special meeting of the stockholders on December 12, 1931, you find that the reduction in value of the common stock was approved and that the credit to earned surplus was authorized, against which, according to the resolution, "any debit balances of other surplus accounts shall be carried."

In preparing a balance-sheet of the company at December 31, 1931, how should you display the item of surplus?

(District of Columbia, May, 1932)

138. The A B C Corporation has an operating deficit on its books at the beginning of the year, amounting to $1,000,000.

Its capital stock consists of 15,000 shares of preferred stock and 15,000 shares of common stock, both at par value of $100 each.

The stock was originally subscribed and paid in at the average rate of $125 per share, the excess over par being credited to surplus.

In order to absorb the deficit the management suggested changing the capital stock from a par value of $100 each share to no par value with a stated value of $40 per share, the number of shares to remain the same.

Some time before the end of the year you have been engaged to audit the corporation for the current year and at the date of this engagement your opinion has been asked about this proposal. The corporation at this time shows that it has made an earning from operations and it is very evident that the year's operations will show a profit.

A. Discuss the above problem and proposal and offer suggestions.

B. How would you show the changes on the balance-sheet at the close of the year?

(American Institute of Accountants, November, 1937)

Questions on Statement of Profit and Loss

139. What effect does the creation of "hidden reserves" have on profits? Illustrate how they may be created. What is the auditor's responsibility concerning them?

(Ohio, October, 1937)

140. For purposes of a corporate report, what is the best method of disposing of losses incurred or discovered during the current year that have no relation to current operations?

(*Wisconsin, November, 1936*)

141. Suggest three bases for a bonus plan for administrative and sales executives of a manufacturing business, and discuss briefly their relative advantages and disadvantages.

(*Ohio, May, 1931*)

142. What recommendations should you offer a client who desires to have his records reflect the best accounting practices with respect to trade and cash discounts on purchases? His capital is sufficiently large to insure his taking advantage of all discounts.

(*Wisconsin, November, 1936*)

143. Explain your version of the following terms:

Net sales.	Work in process.
Cost of sales.	Manufacturing burden.
Gross profit.	Nominal accounts.
Extraneous income.	Perpetual inventory.
Net income.	Commercial burden.

(*Ohio, November, 1931*)

144. To what accounts on the books of a manufacturing corporation should you charge the following expenditures, stating your reasons in each case:

(*a*) Life insurance premium on policy of officers' lives, authorized by board of directors, where the officers are permitted to name the beneficiaries.

(*b*) Cost of new driveway from office to plant.

(*c*) Salary of industrial relations expert.

(*d*) Cost of fire prevention apparatus installed in factory building.

(*e*) Traveling expense of officer to conference on plant code.

(*f*) Membership in chamber of commerce.

(*g*) Cost of annual [illegible] including prices.

(*h*) Repairs to delivery truck damaged in collision.

(*Ohio, November, 1933*)

145. The Polar Ice Cream Company has acquired several new mixing machines under a rent-purchase scheme whereby the manufacturer receives a royalty or rent of 1 cent for each gallon produced, such rent to cease after 300,000 gallons, at which time title will pass to the company. What recommendation should you make for recording the rent on the books?

(*District of Columbia, May, 1933*)

146. In making your examination of a company's records you find the following:

(*a*) Outbound freight charges classified as selling expense.

(*b*) Royalties paid classified as administrative expense.

(*c*) Depreciation on office furniture and fixtures classified as administrative expense.

(*d*) Loss on sales of dismantled factory equipment classified as manufacturing expense.

(*e*) Provision for doubtful accounts (in excess of normal charge of ½ per cent of sales) charged to surplus account.

(*f*) Portion of officers' salaries during course of additional construction charged to plant account.

Should you suggest any change in classification? Explain reason.

(*Ohio, October, 1937*)

147. A concern publishing magazines engaged you to audit their records, and you find as follows:

(*a*) Cash received for one- to five-year subscriptions has been credited to income.

(*b*) The sales invoices, for advertising space in the magazines, has also been credited to income.

(*c*) Premiums, given with subscriptions, are charged to expense at time of publication.

What, if any changes should you make?

(*Ohio, May, 1932*)

148. Explain deferred income; tell how it arises and what disposition would be accorded it at date of closing of books. Give an illustration showing the adjustment necessary at the close of a fiscal period so as to reflect in the income account the correct profit for the period, applicable to instalment sales, where the company follows the plan of accounting.

(*Ohio, May, 1934*)

149. In conducting an audit of a wholesale company, you note the following accounts on the general ledger:

Cash discounts lost (debit balance)	$1,432.73
Cash discounts not taken (credit balance)........	5,733.40

What, in your opinion, is the meaning of these accounts, and how will you dispose of them in preparing the income statement of the business?

Submit pro-forma journal entries illustrating a purchase and a sale under the procedure obviously followed by the company.

(*American Institute of Accountants, November, 1932*)

150. In the review of net profits over a series of years preparatory to the issuance of a bond circular on which earnings are to be displayed and preparatory to the presentation of the same figures to a group of promoters interested in merging the company with several competitors, what attention should be given to the following items:

(*a*) Inventories.

(*b*) Capital and revenue expenditures.

(*c*) Depreciation, where an appraisal has been made showing the appraisal value at the opening date of the period under examination, with the appraisal value of additions and deductions during each of the years under review. The appraisal values are to be used in the published balance-sheet.

(*d*) Surplus.

(*e*) Administrative expenses.

(*District of Columbia, May, 1931*)

151. With the lowering of interest rates there has been much refunding of bond issues, either by exchange of new lower interest rate bonds for old or by the redemption of old bonds with the proceeds from sale of new. Discuss the proper accounting treatment of discount and expenses of the new as well as unamortized discount and expenses of the old issue.

(*Ohio, May,* 1937)

152. A merchandising corporation shows in its profits for the year under audit a large amount of anticipated cash discounts on its accounts payable. Discuss the pros and cons of this practice.

(*American Institute of Accountants, May 1933*)

153. Some accountants permit construction companies to take into the profit and loss a proportion of earnings on any given job based upon its stage of completion. Do you approve, or should you suggest another method?

(*Ohio, November, 1931*)

154. The White Construction Company has several large contracts in process of completion. Certain of these jobs are on a cost-plus basis, and others are on a contract-price basis. No profit or loss has been taken on these jobs for the period under audit. How should the profit or loss be reflected at the end of the accounting period? Discuss fully.

(*Wisconsin, November, 1934*)

155. A manufacturer finds that he is overstocked with considerably more raw material than his production schedules require over the next six months' period. He makes a substantial sale of his raw materials to another manufacturer at a considerable profit and includes the sale with the other sales of the company's product. You also find that returns of finished product sold in prior years have been deducted from current sales. What should you suggest under the circumstances?

(*Ohio, October, 1937*)

156. Under which, if any, of the following conditions would you permit interest to be considered a part of manufacturing cost and of inventory valuation? State the general governing principle. Give reasons.

(a) A manufacturing company in leasing its premises in lieu of a fixed rental pays the lessor a stipulated rate of interest upon his investment in the premises plus a royalty upon the quantity of products manufactured.

(b) A timber company, having held a tract of timber for a long period, has capitalized the interest upon the mortgage on the timber; and now, upon manufacturing the timber into lumber, proposes to write off depletion based on book values.

(c) A sugar plantation and factory, newly organized, has set up interest on money borrowed to raise its first sugar-cane crop as part of the cost of the crop during the two years required to raise it.

(d) A cocoanut-oil manufacturer buys copra in the Philippines accepting in settlement an [illegible] draft which is forwarded by the sellers to their bankers in San Francisco with bill of lading attached. The same copra could have been purchased f.o.b. San Francisco at a higher price.

(*American Institute of Accountants, November, 1930*)

157. The X Corporation desiring additional capital submits to an investment company a statement in which the "net income for 1934 available for dividends" is shown as $65,000.

You are engaged by the investment company to audit the books of the X Corporation for the purpose of verifying this net income. Your audit discloses the following facts which are not shown in the statement, viz.:

(a) Depreciation for the year amounting to $16,000 was not provided;
(b) Dividends of $25,000 on preferred stock were payable on the day following the date of the statement;
(c) A machine manufactured by the corporation for its own use at a cost of $12,000 was charged to machinery account at the market price of similar machines, namely, $17,000;
(d) In accordance with the terms of a trust deed under a bond issue $15,000 should have been credited out of net income to a sinking fund reserve;
(e) There was included in the net income $12,000 derived from non-recurring transactions apart from the usual business operations;
(f) No provision was made for the 1934 federal income tax.

Explain how each item should have been treated on the books or on the statement, and prepare summaries showing (a) the correct net earnings and (b) the net income available for dividends.

(*American Institute of Accountants, November, 1935*)

158. The Golf Club submits its cash account for the calendar year 1936 with the request that you prepare a statement of income and expense for the period.

Summary:

Balance, January 1, 1936	$ 4,000	Clubhouse expense	$25,000
Members' dues	30,000	Golf course expense	12,000
Locker rentals	2,400	Miscellaneous	2,400
Green fees	3,000	Restaurant expense	22,000
Initiation fees	2,000	Bar and tobacco	10,000
Room rent	2,000	Administrative expense	5,000
Restaurant accounts	25,000	Maintenance	2,000
Bar and tobacco	15,000	Balance, December 31, 1936	5,000

	January 1, 1936	December 31, 1936
Audit items:		
Accounts receivable:		
Members' dues	$4,000	$2,000
Restaurant accounts	1,000	2,000
Inventories:		
Restaurant	700	900
Bar and tobacco	800	500
Accounts payable:		
Clubhouse expense	900	300
Golf course expense	200	300
Restaurant expense	600	400
Members' credit balance	1,200	1,500
Accrued taxes	2,000	3,000

It is estimated that 10 per cent of all accounts receivable will be uncollectible. Disregard depreciation and federal taxes.

(Ohio, May, 1937)

Ratios

159. Define turnover in merchandising or manufacturing, and state how it is to be ascertained.

(American Institute of Accountants, November, 1931)

160. State what each of the following ratios indicates, and explain how each is determined:

Working capital ratio.
Finished goods turnover.
Ratio of net sales to accounts receivable.
Ratio of net sales to finished goods inventory.
Ratio of net sales to plant and equipment.
Ratio of capital and surplus to plant and equipment.

(Ohio, May, 1933)

161. (a) State briefly what information you would expect to obtain from the following ratios, viz.:

(1)	Operating profits	to Operating capital employed,
(2)	Net sales	to Operating capital employed,
(3)	Working capital	to Operating capital employed,
(4)	Net sales	to Gross fixed assets,
(5)	Net sales	to Receivables,
(6)	Cost of goods sold	to Inventories,
(7)	Net worth	to Total assets,
(8)	Current assets	to Current liabilities,
(9)	Cash	to Current liabilities,
(10)	Net income	to Net worth.

(b) When does the information become really useful?

(*American Institute of Accountants, May, 1936*)

162. The Chocolate Manufacturing Company have issued preferred stock under an agreement to maintain net tangible assets to an amount not less than 250 per cent of the preferred stock outstanding and also to maintain current assets at not less than 200 per cent of the current liabilities with the net working capital to be maintained at not less than 150 per cent of the preferred stock outstanding. On December 31, 1931, they submitted the following balance-sheet:

Cash		$ 25,000
Notes and accounts receivable—net		75,000
Inventories		100,000
Total current assets		$200,000
Fixed assets—net		150,000
Goodwill		50,000
Total assets		$400,000
Notes payable (current bank loans)	$ 20,000	
Accounts payable	30,000	
Bonds issued (1931)	50,000	
Total liabilities		100,000
Preferred stock	$100,000	
Common stock	100,000	
Surplus	100,000	
Total proprietorship		$300,000

As an accountant representing the interests of the preferred stockholders, you ascertain that during 1931 bonds were issued and the proceeds were used to liquidate current accounts payable. Also that in December $100,000 of cash was paid to banks and trade creditors. Show, by means of ratios, the condition before these transactions occurred and also at date of balance-sheet. Comment briefly on your findings.

(*Wisconsin, May, 1932*)

Partnership Agreement

163. You are engaged to draw up a partnership agreement for a firm about to be organized. State at least ten important points to be covered in such an agreement.

(*American Institute of Accountants, November, 1930*)

Partnerships—Division of Profits

164. F, G and H enter in an agreement with a farmers' marketing association to dispose of its members' peach crop. The three individuals will act jointly as the agent of the association, will share equally in income accruing to them as agent and will be compensated as follows: $500 each plus one-third each in a bonus based on the net yield to the association. "Net yield" is defined in the agreement as "selling price less freight and commission-dealers' commission and expenses and less compensation to parties of the second part (F, G and H)." The contract further specifies that if "the average net yield is greater than $1 per bushel," the bonus will be "10 per cent of the net yield above $1, 1 per cent of the net yield above $1.12½, and additional 1 per cent, up to a maximum of 10 per cent, of successive 12½-cent additions to such net yield, it being contemplated that said bonus shall in no event exceed 20 per cent of the net yield above $1."

You have been called upon to prepare a statement for presentation to the association, based on your interpretation of the contract, showing the profit to the association and the amount of cash to be paid to each of the three individuals. The crop amounted to 152,564 bushels and was sold by F, G and H to commission dealers at an average selling price of $2.20 from which the

dealers deducted commission of 6 per cent, freight of $14,713.20 and expenses of $3,289.35. Out of the net proceeds (which were remitted direct to the association) advances were made to F amounting to $8,000 and to G, $2,500.

(*District of Columbia, November, 1936*)

Partnerships—Change in Interest

165. A, B and C have operated a partnership business for several years, dividing all profits one-third each. A advanced the entire capital at organization in the amount of $5,000. The business is now worth $155,000 without considering goodwill, and A has been asked to sell out to B and C. Since nothing was ever said about the status of the original capital, A believes that he is entitled to more than one-third of the present net worth. Using the following added information, what would your opinion be as to A's rights?

Date of organization—January 1, 1932.
Date of dissolution—January 1, 1935.
Profits earned $50,000 each year.
Estimated profits for 1935—$100,000.
Salaries have been equal, and services rendered considered to be of equal value.

(*Ohio, May, 1935*)

166. Carr and Plane are in partnership sharing profits 60 per cent and 40 per cent, respectively. During 1931, as a result of overexpansion of plant facilities, they find themselves in need of cash, although the business is a profitable one. They also find that proper supervision of the increased plant requires the services of a third man, and they decide to admit Truck as a partner. Truck agrees to come in on July 1, 1931, on the following conditions:

a. Truck is to pay in, at once, $25,000 in cash.

b. The capital accounts of Carr and Plane are to be credited with goodwill which is agreed to be four times the net profit for 1931 in excess of $35,000.

c. A reserve for contingencies and adjustments of $5,000 is to be created by charging Carr and Plane and carried as a liability.

d. Profits for 1931 are to be carried to the investment accounts, Truck to receive one-fourth and Carr and Plane to share in the same proportion between themselves as formerly.

e. Truck is then to pay in an additional amount of cash to bring his capital up to one-fourth of the total partnership capital.

Prepare a balance-sheet as of December 31, 1931, giving effect to the preceding agreement. Item *a* is the only adjustment so far reflected in the accounts.

Trial balance, December 31, 1931

Accounts	Debits	Credits
Cash	$ 8,300	
Accounts receivable	30,410	
Reserve for bad debts		$ 1,524
Merchandise inventory, January 1, 1931	22,000	
Land	60,000	
Building and equipment	192,300	
Reserve for depreciation		8,500
Prepaid expenses	1,939	
Notes payable		20,000
Accounts payable		79,000
Carr, investment		90,000
Plane, investment		60,000
Truck, investment		25,000
Merchandise sales		298,100
Discount on purchases		1,900
Merchandise purchases	249,000	
Salaries and wages	10,140	
Other selling expense	4,800	
Taxes	1,100	
Insurance	503	
Repairs	82	
Office expense	2,650	
Interest expense	800	
Totals	$584,024	$584,024

Additional closing data:

Of the prepaid expenses, $42 is chargeable to insurance and $180 to other selling expense.

Accrued taxes, $100; accrued wages, $900; merchandise inventory, $36,968.

Depreciation at the rate of 2 per cent should be allowed, and $825 added to the reserve for bad debts.

(*Wisconsin, May, 1932*)

Partnerships—Liquidation

167. Brown, Smith & Jones, a firm, decided to dissolve partnership and to liquidate the business. Lacking confidence in each other, the partners employ you to conduct the liquidation and to determine the correct amounts due from or to each partner.

Describe in detail the steps you will take.

(*American Institute of Accountants, November, 1934*)

Partnerships—Sale or Conversion to Corporation

168. A and B, partners, decide to incorporate, and you are asked to determine a value for goodwill. (*a*) What method should you use? (*b*) Should you issue stock for the value decided upon? (*c*) Should this value be depreciated, amortized or otherwise written off? Explain fully.

(*Ohio, October, 1930*)

169. Give the journal entries to close the books of the A and B partnership and open the books of the X Corporation as at December 31, 1936.

Partnership	Debits	Credits
Cash	$ 8,000	
Accounts receivable	10,000	
Inventories	15,000	
Real estate	12,000	
Deferred	1,000	
Accounts payable		$18,000
Partnership net worth—A and B		28,000

Capital stock authorized 1,000 shares without par value, stated value $50 per share. Subscribed by outsiders 300 shares, received cash $10,000 on these subscriptions. A and B own equally the net worth of the partnership, but B sold 50 shares of his stock to C at $50 per share. As of January 31, 1937, the company sold 100 shares at $60 per share and received cash in full; also all outstanding subscriptions were received as of that date.

(*Ohio, May, 1937*)

Mergers and Consolidations

170. Prepare the opening entries to record the purchase of the A Company by X Company as of December 31, 1932, for $800,000 (8,000 shares at $100 par value).

Assets

Current	$ 230,000
Fixed	800,000
Deferred	12,000
Total	$1,042,000

Liabilities

Current	$ 92,000
Funded debt	250,000
Capital stock	400,000
Surplus	300,000
Total	$1,042,000

(*Ohio, May, 1934*)

171. In auditing the A Corporation you find that during the year it has taken over the assets (except goodwill) and the liabilities of the B Corporation in exchange for an agreed amount of stock of the A Corporation at par. The said assets and liabilities have been merged with those of the A Corporation, and the latter's goodwill account has been increased to balance the balance-sheet after merger. You are satisfied that all values are sound.

(a) What is indicated as to the consideration paid by Corporation A?

(b) Should it be reflected in the goodwill account of A or not? Give your reasons.

(c) In what other manner might the transaction be treated on A's books?

(d) Supposing the conditions upon which your answer to (a) is based to be reversed, how would you treat the transaction?

(*American Institute of Accountants, November, 1933*)

172. The X and Y companies, competing enterprises, merge and form the Z Company. Their net worths on the day of the merger are as follows:

Particulars	X Company	Y Company
Preferred stock—300 shares	$ 30,000	
Common stock—500 shares	50,000	
Common stock—1,000 shares		$100,000
Earned surplus	760,000	300,000
Total net worths	$840,000	$400,000

Immediately before the merger the preferred stock of the X Company is retired, and a cash dividend of 20 per cent and a

dividend of 300 per cent payable in common stock are declared on the common stock. In this manner the book value of each share of outstanding stock of both companies is fixed at $400 per share. The merger is then effected, 3,000 shares (par $100) of the stock of the newly formed Z Company being exchanged, par for par, for the stock of the old companies.

Your opinion is solicited as to the correct disposal of the two earned-surplus accounts in opening the books of the Z Company.

(*District of Columbia, May, 1932*)

173. Objections are frequently raised to consolidated statements submitted to holding-company stockholders and creditors as informative statements. Suggest and discuss possible remedies.

(*Wisconsin, November, 1935*)

174. What principles determine the necessity for consolidation or nonconsolidation of financial statements in the case of parent and subsidiary relationships?

(*District of Columbia, May, 1936*)

175. In preparing the consolidated balance-sheet of a company having many subsidiaries, you are confronted with situations where a number of companies are but 50 per cent owned yet where unquestionably operating control exists. What factors will determine your decision to consolidate or not?

(*District of Columbia, May, 1936*)

176. A 60 per cent subsidiary company issues a stock dividend in no-par common stock having a stated value of $30; of the surplus transferred to stated value, one-half was earned before the parent company's interest was acquired, and one-half thereafter. How should the parent company record the dividend received, and what will be the effect on a consolidated balance-sheet?

(*District of Columbia, May, 1936*)

177. (*a*) Under what conditions is a subsidiary corporation deemed to have goodwill (not shown on the books) at the time the parent company acquired control? (*b*) What effect do profits earned by a subsidiary corporation have on the surplus

account of the parent company when a consolidated balance-sheet is prepared?

(*Ohio, November, 1933*)

178. The A Holding Company paid to The B Corporation $125,000 for the entire issue of capital stock which was represented by 1,000 shares, having a par value of $100 per share and a book value of $120 per share. In preparing a consolidated balance-sheet on the date of acquisition, how should the excess payment of $5 per share be shown? Would your answer be the same if The A Holding Company purchased a 90 per cent interest in the stock of The B Corporation for $113,000?

(*Ohio, November, 1934*)

179. A 51 per cent ownership in the common stock of a subsidiary was acquired in small amounts by its parent from the subsidiary's stockholders over a period of several years; the last purchase of approximately 5 per cent on April 30, 1936, was sufficient for the parent to obtain its 51 per cent control. In preparing a consolidated balance-sheet reflecting the present ownership, how should you dispose of surplus of the subsidiary applicable to the various purchases in prior years, and how should you dispose of dividends now paid to the parent from such surplus?

(*Wisconsin, November, 1936*)

180. As of April 1, 1930, Company A acquired, at costs of $400,000 and $350,000, respectively, a 90 per cent interest in Company B and an 80 per cent interest in Company C. The net worths of the two companies acquired, as of that date, were as follows:

	Capital stock	Earned surplus
Company B	$250,000	$250,000
Company C	300,000	100,000

How should you state the capital accounts in a consolidated balance-sheet as of June 30, 1930, assuming Company A's net worth to have been $1,000,000 at April 1, 1930 ($700,000 capital stock and $300,000 earned surplus) and the operating results for the intervening three months as follows:

Company A, profit	$20,000
Company B, profit	6,000
Company C, loss	2,000

(Ohio, May, 1934)

181. In valuing inventories for the purpose of a consolidated balance-sheet of a corporation controlling several operating subsidiaries, what adjustments, if any, should you consider necessary where intercompany sales are billed at prices that allow a profit to the selling company? In the event that there should be minority stock holdings in the subsidiaries, owned outside the parent company, what should be your method of adjustment? *(Ohio, May, 1934)*

182. (a) The Interstate Holding Company owns capital stock of three subsidiary companies, A, B, and C, in proportions (to the total outstanding stock of each) of 95%, 90% and 60%, respectively. In preparing statements of the holding company for the guidance of its directors in deciding upon the declaration or omission of dividends, what cognizance, if any, would you take of the following facts?

1. That the book value of A Company's stock is less than that at which it is carried by the holding company because of heavy losses incurred in the current year through inefficient management.

2. The book value of B Company's stock is substantially less than that at which it is carried by the holding company, as a direct result of the subsidiary's having declared and paid dividends during the current year in excess of profits.

3. That C Company's stock, which is carried on the holding company's books at an average cost in the open market of $84 a share, is quoted on the New York stock exchange at $10 at the balance-sheet date. Investigation shows that this shrinkage is directly attributable to two factors, (1) adverse conditions in the industry and (2) general financial conditions and other causes entirely unrelated to the business.

(b) State briefly what your treatment of the foregoing factors would be in preparing a balance-sheet for the holding company. *(American Institute of Accountants, November, 1933)*

183. The directors of a subsidiary company pass a resolution appropriating surplus earnings as dividends. The earnings,

amounting to $60,000, are paid to the holding company direct. The holding company owns 80 per cent of the capital stock of the subsidiary.

(*a*) How should you treat this dividend on a consolidated balance-sheet after the declaration but before the payment?

(b) What would the entries on the books of the holding company be after the payment of the dividend?

(*Ohio, May, 1931*)

184. Company B sells an issue of ten-year bonds, amounting to $600,000 par value, to its wholly owned subsidiary for $540,000 cash. How would the transaction be entered on the records of the two companies? If you were auditing the books at the end of one year after the bonds were issued, how would you treat this in the consolidated balance-sheet? Individual balance-sheets? Profit and loss statement?

(*Ohio, May, 1933*)

185. Z, a domestic corporation, owns all of the outstanding stock of Y, a Canadian corporation, and carries the investment on its books at $140,000. The subsidiary's balance-sheet is as follows:

Assets		*Liabilities*	
Cash	$ 10,000	Accounts and notes payable—current	$ 30,000
Accounts receivable	60,000	Capital stock	100,000
Real estate and equipment	100,000	Surplus	40,000
Total	$170,000	Total	$170,000

When Canadian exchange is at 85, on what basis would this balance-sheet be included in a consolidation with Z?

(*Ohio, May, 1933*)

186. Prepare a consolidated balance-sheet of the A Company and its subsidiaries B and C from the following individual statements as of December 31, 1932:

	A	B	C
Sundry assets	$ 90,000	$100,000	$40,000
Investments:			
Subsidiary B	55,000		
Subsidiary C	20,000		
Totals	$165,000	$100,000	$40,000

	A	B	C
Sundry liabilities	$ 65,000	$ 25,000	$10,000
Capital stock	100,000		
A Company		30,000	20,000
Minority		20,000	5,000
Surplus:			
A Company		15,000	4,000
Minority		10,000	1,000
Totals	$165,000	$100,000	$40,000

(*Ohio, November, 1933*)

187. The X Company, which owns 90% respectively of the stocks of the Y and Z Companies, submits consolidated statements showing, among other things:

Income of $9,000 dividend received by the Y Company, which actually earned $12,000 during the current year.

Net liability to minority stockholders of Z Company $9,000, which is explained to be the difference between the minority capital stock of $10,000 and a loss of $1,000 for the current year sustained by the Z Company.

If you find any error in either or both the above items, state how it should be corrected.

(*American Institute of Accountants, November, 1933*)

188. The Holding Company owns companies A, B, and C. Assume that the net profit of Company A and Company C is 10 per cent on total cost and that the net profit of Company B is 25 per cent. The income statement for Company A shows that it produced goods during the period costing [illegible], of which 50 per cent was sold to Company C, 30 per cent to outsiders and 20 per cent is on hand. The income statement of Company C shows produced goods of $200,000, of which $55,000 was purchased from Company A, $5,000 from Company B, $105,000 from outsiders and other costs $35,000. Company C sold 80 per cent of its produced goods to outsiders, and the balance is on hand. Company B's cost amounted to $3,750. How much of the earnings of the subsidiary companies should be treated as net income by the Holding Company?

(*Ohio, May, 1935*)

189. (*a*) The Parent Holding Company has control of 80 per cent of the voting stock of the Young Subsidiary Company which

it acquired in 1934 at a cost of $1,000,000. At time of acquisition the Young Subsidiary Company had capital stock outstanding of $500,000 and a surplus of $250,000. On December 31, 1936, the Young Subsidiary Company has a surplus of $300,000.

1. Show in journal entry form the adjustments to be made to eliminate the investment in subsidiary stock for the purpose of obtaining a consolidated balance-sheet as of December 31, 1936.

2. Give the journal entry to set up the minority interest in the consolidated balance-sheet as of December 31, 1936.

(*b*) The Parent Holding Company owns 80 per cent of the voting stock of the Young Subsidiary Company. The Young Subsidiary Company owns and controls 75 per cent of the stock of the Star Operating Company. The Star Operating Company sold $10,000 of merchandise to the Parent Holding Company which cost $7,000 to produce. This is still in the inventory of the Parent Holding Company on December 31, 1936.

1. Give the journal entry to eliminate properly intercompany profits for consolidated balance-sheet purposes.

(*Wisconsin, November, 1937*)

Cost Accounting

190. (*a*) Name the three principal elements of manufacturing cost. (*b*) What are the usual items included in overhead, or burden? (*c*) Explain the methods commonly used in distributing overhead, or burden.

(*Ohio, November, 1933*)

191. A small plant manufacturing paints does not maintain and cannot afford a complete cost system.

(*a*) What records should you install so that the management could have sufficient cost information necessary to determine the sales prices?

(*b*) Would a perpetual inventory be necessary?

(*Ohio, May, 1931*)

192. Factory overhead being considered as a proper element of the cost of manufacture,

(a) What expenses or other charges of a manufacturing company are usually excluded from factory overhead? Name at least four classes.

(b) What is the proper treatment of overhead expenses where materially reduced production has caused a large increase in overhead rates?

(*American Institute of Accountants, May, 1937*)

193. (*a*) How should you value a by-product inventory? (*b*) How should you include on a profit and loss statement the direct labor, materials and manufacturing overhead used in producing by-products?

(*Ohio, October, 1930*)

194. Name at least four methods of distributing departmental plant overhead to the manufacturing costs and the conditions under which each method should be used.

(*American Institute of Accountants, May, 1937*)

195. How do "standard" costs differ, if at all, from "estimated" costs?

(*Wisconsin, November, 1935*)

196. What is unabsorbed burden? From what does it result, and how should it be treated in an operating statement? A newly organized company about to open a coal mine is primarily interested in a system of accounting with respect to its plant accounts which will insure uniformity of costs throughout its operations. Suggest an outline of procedure that theoretically offers greatest assurance of the desired result.

(*Ohio, May, 1931*)

197. (a) What is meant by "fixed" and "variable" overhead costs in cost accounting for a manufacturer?

(b) Give examples of each.

(c) How will increases and decreases in production affect the variable and fixed overhead in the cost per unit?

(d) Illustrate by example your answer to (c).

(e) Why should any distinction between fixed and variable costs be recognized?

(*American Institute of Accountants, May, 1935*)

198. Even though extreme care is employed in setting standards to measure performance of a standard cost system, it is unreasonable to expect that actual conditions will correspond exactly with the standards. Outline the variances to be con-

sidered under these circumstances for material, direct labor and factory overhead.

Distinguish between the order method and the process method of cost finding.

(*Ohio, November, 1934*)

199. Your client employs standard costs in its accounting. At December 31 you find the inventory of finished product, valued according to the predetermined "standards," slightly less than current market values. The number of units produced during the current year was 20,000 of which 8,000 units were on hand at December 31. There was no inventory at January 1. In the trial balance you find the following accounts:

	Debit	Credit
Material variance	$ 2,000	
Labor variance		$1,200
Overhead variance	40,000	

How should you proceed in handling these items?

(*Ohio, November, 1931*)

200. In the preparation of financial statements at December 31, 1930, of a manufacturer operating a standard cost system, what disposition should be made of the following items:

(*a*) Loss and gain on materials (credit, $11,998) representing the difference between the standard cost at which raw materials are taken into the inventory and the actual cost.

(*b*) Loss and gain on labor (debits, $3,868) representing the difference between the standard cost of labor charged to operations and the direct labor cost.

(*c*) Loss and gain—shop expense (debits, $157,995) representing underabsorbed plant overhead.

(*d*) Loss and gain—variations in standard costs (credit, $1,178) representing the difference between increases and decreases in inventories resulting from changes in standard costs.

(*District of Columbia, May, 1931*)

201. A standard cost system was installed several years ago by the A Company as a result of which it has been distributing its factory overhead on a basis equivalent to approximately 200 per cent of direct labor. For 1929, however, the actual ratio of factory overhead to direct labor was 400 per cent, as com-

pared to 450 per cent for 1928. Work in process and finished stock at the end of each of these years were valued as follows:

Particulars	December 31 1928	December 31 1929
Material	$120,000	$150,000
Direct labor	40,000	54,000
Factory overhead	80,000	108,000
Total	$240,000	$312,000

Because of the low profit showing for 1929, it has been suggested that the closing inventory be valued on the basis of the actual overhead ratio for 1929, it having been determined that the closing inventory contained no items on hand at January 1.

Outline the position that you would take as auditor of the company's accounts for the year 1929.

(*District of Columbia, May, 1930*)

202. Most accountants believe that cost of sales should be stated on a basis of cost under normal operations. Discuss this proposition, and indicate how "abnormal" costs can be reflected in the income statement.

(*Wisconsin, November, 1935*)

203. The Bellvue Manufacturing Company has invested $25,000 in a filling machine to be used in an operation previously performed in an outside shop. Under normal conditions this "special purpose" machine is in use only two or three hours a day. The factory overhead allocated to the new machine center is $160 per 5½-day week. A 9-hour-per-day basis is used for computing other machine rates, but to employ the same basis for the filling machine would make it appear that it is not paying for itself. A rate based on normal running hours, on the other hand, would seem to penalize unduly the products of this machine.

In your opinion how should the correct hourly machine rate be determined?

(*District of Columbia, May, 1933*)

204. Indicate what adjustments, if any, should be made under the following conditions.

Total direct labor	$500,000
Total direct material	750,000
Total factory burden	325,000

Factory burden includes $25,000 of interest on investment.

	Work in process	Finished goods	Cost of sales
Material	$140,000	$130,000	$ 480,000
Labor	70,000	110,000	320,000
Burden	45,500	71,500	208,000
Totals	$255,500	$311,500	$1,008,000

(*Wisconsin, November, 1937*)

205. The following plant analysis was made of the Garden Implement Company:

	Dept. A	Dept. B	Dept. C
Dimensions	40 × 30	20 × 30	60 × 30
Valuation of equipment	$10,000	$ 12,000	$ 10,000
Direct labor hours	60,000	40,000	100,000
Horsepower-hours	60,000	110,000	10,000

The budgeted expenses for the year are:

Taxes on building	$ 1,500
Taxes on personal property (equipment)	2½ %
Depreciation on building	1,200
Depreciation on equipment:	
Departments A and B	5 %
Department C	7½ %
Repairs to building	900
Repairs to equipment	
Department A	325
Department B	400
Department C	150
Insurance on building	1,050
Insurance on equipment	640
Power	12,000
Heat	1,080
Light	600
Indirect labor	8,400

From the foregoing, prepare a schedule showing the distribution of each of the budgeted items to departments upon an equitable basis. Also show the total burden of each department, and determine the departmental burden rates on a direct labor hour basis. Carry only four places.

(*Wisconsin, May, 1932*)

Receiverships

206. The X. Y. Corporation becomes insolvent and you are appointed receiver. State in detail the system of accounting you will adopt, and the form of your final report to the court.

(*American Institute of Accountants, May, 1933*)

207. Assuming that The A Manufacturing Company has become insolvent, (*a*) at what value should you show the treasury stock on a statement of affairs of the company? (*b*) If the original stockholders take possession of machinery under a chattel mortgage, what journal entries should you make?

(*Ohio, November, 1933*)

208. Your audit of the records of N, a bankrupt company, disclosed the following entries made one day before adjudication by the court.

(a) Journal entry crediting the account receivable of O Company and debiting the account payable of O Company with $10,000 to offset accounts representing mutual dealings.

(b) Cashbook entry applying entire bank balance of $25,000 in reduction of an unmatured note of $50,000 to the same bank.

(c) The sale and delivery of all merchandise on hand at current market sales prices to P Company, holder of unmatured notes payable of the N Company which are personally endorsed by officers of the N Company. The merchandise is delivered in full and final settlement of these notes.

Comment upon these transactions.

(*American Institute of Accountants, November, 1934*)

Estates

209. In estate accounting, differentiate between principal and income. What expenses are payable out of principal? Out of income?

(*Ohio, October, 1937*)

210. A receiver in equity may prepare a statement of affairs at the inception of the receivership. Outline the form of such a statement, using your own account captions.

(*Ohio, October, 1937*)

211. How should the executor of an estate charge the following items as between corpus and income?

1. Physician's fees for last illness.
2. Funeral expenses.
3. Expenses of probating will.
4. General expenses of executor.
5. Loss on sale of investment.
6. Legal fees for collection of rents.
7. Legal fees for defending claims against the estate.
8. Executor's commissions.
9. Repairs to office buildings.
10. Estate and inheritance taxes.
11. Fire-insurance premium.
12. Special assessments adding permanent value to real estate.
13. Monthly allowance to beneficiaries.
14. Expenses incident to a change in executor.

(*American Institute of Accountants, November, 1934*)

212. You are requested to prepare an accounting to the probate court for the executor of the Brown Estate. Among the items to be considered are those shown below. State which are properly chargeable to corpus and which to income:

(1) Federal income tax for a fiscal period during the administration of the estate, a large portion of the tax being based upon gain on sale of securities which are part of the corpus.

(2) Real-estate taxes which were a lien upon the property at the time of the decedent's death.

(3) Physician's and nurses' fees for attendance upon the decedent.

(4) Funeral expenses.

(5) Losses on sale of investments owned by decedent and taken over by the executor.

(6) Taxes upon improved property during the administration of the estate.

(*American Institute of Accountants, November, 1937*)

213. In accounting for an estate, as a general rule, under which heading, corpus or income, should the following items be placed:

(*a*) Legacies paid in cash.

(*b*) Proceeds from the sale of bonds of testator.

(*c*) Profit from the sale of bonds of executor.
(*d*) Dividends received on investments of testator.
(*e*) Funeral expenses.
(*f*) Monthly allowance to beneficiary provided for in the will.

According to a will, certain heirs, during their lifetime, were to receive the annual income from an estate; and upon their death, the estate would be divided equally among other heirs. The first two years after the death of the testator, the estate was operated at a loss; during the third year, net income from the estate equaled the net loss for the two preceding years. What distribution, if any, should the executor make to the life tenants?

(*Ohio, May,* 1936)

Brokerage

214. A partner in a stock-brokerage firm, not active in the management, suspects his firm of conducting a "bucket-shop." He makes an examination of the customers' accounts and finds them all, both long and short, amply margined. The market has been rising steadily for nearly a year.

He obtains a balance-sheet from the firm's books and submits it to you for your advice. The balance-sheet shows the following pertinent items:

Cash	$ 400,000
Due from customers, long	2,500,000
Due from brokers for stock borrowed	25,000
Securities on hand	75,000
Firm trading accounts, long	450,000
Due to customers, short	375,000
Due to brokers for stock loaned	150,000
Firm trading accounts, short	2,850,000
Capital, surplus, and profit and loss	75,000

What would be your advice, and why?

(*American Institute of Accountants, May, 1931*)

Retail Accounting

215. In preparing a budget for a retail department store, the budget period might be a year, six months, or a quarter. What advantages if any would each possess as a period for budgeting? Which length of period do you favor? Would you favor this period in all cases?

(*Ohio, November, 1934*)

216. You are asked to distribute the following expenses among the six departments of a store:

(*a*) Insurance.
(*b*) Rent.
(*c*) Delivery.
(*d*) Show window.
(*e*) Advertising.
(*f*) General administrative.
(*g*) Group life insurance.

(*Ohio, May, 1934*)

217. The owner of a chain of retail glove stores desires to lease the glove department of a department store. He believes that the rental should be based on a percentage of sales and requests you to outline the terms of a tentative lease to be submitted to his attorney. Submit, in outline form, your proposals, covering particularly the following points:

(*a*) Ratio of rent to sales.

(*b*) Who shall furnish the merchandise and keep control of the stock in this department, the lessor or the lessee? Explain the method of control briefly.

(*c*) Who shall bear the expense of the payroll for saleswomen employed in this department?

(*d*) Who shall bear the expense of (1) direct advertising, (2) general advertising, (3) window display space?

(*e*) Shall light and heat be apportioned to the lessee?

(*f*) How often should a cash settlement be made between the lessor and lessee? Who is obliged to make the remittance?

(*g*) What contact will the customer have with the lessee? In case of displacement of the selling force, who will have final authority?

Describe five essentials of internal check in a manufacturing business, and state why each is considered important.

(*Pennsylvania, November, 1931*)

Consignments

218. In auditing the records of a corporation, you find accounts receivable representing charges to dealers for merchandise on consignment. The charges represent invoices at regular contract prices, and the credits represent dealers' deposits equal

to 60 per cent of invoice prices. How should you treat these accounts in preparing a balance-sheet?

(*Ohio, November, 1931*)

219. Show how the following data should appear in the balance-sheet and/or the profit and loss statement of the consignor:

Consignment shipments at 10% above cost . .	$550,000
Consignment sales by consignee at his selling price.	600,000
Inventory of consignment shipments received at consignor's shipment price	66,000
Goods in transit (to consignee) at consignor's shipment price	22,000
Remittances by consignee	330,000
Accounts receivable on consignee's books . .	80,000

The contract specifies that the consignee is to assume all losses for bad debts.

(*Wisconsin, November, 1937*)

220. During the course of your audit of the accounts of the Y Company you discover an account, detailed below, covering merchandise shipped to customers on consignment.

Particulars			Debits	Credits
Balance, January 1, 1931, at billing prices to customers (factory cost $14,214.96)			$ 18,834.12	
Shipments to customers at billing prices (factory cost $93,531.63); offsetting credit to sales			127,386.91	
Cash received from customers as indicated by following account-sales rendered:				
Sales (factory cost $88,326.53)		$139,426 91		
Less:				
20% commission.	$27,885.38			
Freight, storage, and other charges. .	1,263 81	29.149.19		$110,277.72
Defective merchandise returned by customers, credited to this account at billing price and charged to defective merchandise (an expense) account. Factory cost of these returns was $4,383.66, and the merchandise had no scrap value.				5,568.11
Totals.			$146,221.03	$115,845.83
Debit balance per books at December 31, 1931				30,375 20
Totals . .			$146,221 03	$146,221.03

Prepare journal entries adjusting the preceding account, and state how you would treat the balance on the financial statements of the company at December 31, 1931.

(*District of Columbia, May, 1932*)

Instalment Sales

221. An old-established corporation, selling personal property, is considering changing its accounting over to the instalment basis. What balance-sheet and income and expense accounts would be affected by the change, and in what manner?

(*Ohio, May, 1937*)

222. A furniture dealer keeps his books on the instalment basis, carrying as a deferred credit the unrealized profit on instalment accounts. Under such conditions should you consider it necessary to provide an allowance for uncollectible accounts?

(*Ohio, May, 1936*)

223. A retail furniture store selling on the instalment plan had uncollectible accounts receivable aggregating \$60,000 at December 31, 1933, in respect of which merchandise had been repossessed which originally sold for a total of \$100,000. The management now estimates that this repossessed merchandise will resell at \$50,000 after a reconditioning outlay of \$5,000. Show the result of these transactions in the form of such journal entries as would be necessary for a correct reflection of the store's financial accounts as of December 31, 1933. At what amount should you value this repossessed merchandise for inventory purposes?

(*Ohio, May, 1934*)

224. Illustrate the entries necessary to record the sale of merchandise on the instalment plan and to show the realized profit calculated on the basis of current collections by using the following facts: Grand piano costing \$600 sold to John Doe for \$1,200; cash received upon delivery, \$250; balance to be paid in \$50 instalments.

(*Ohio, October, 1937*)

225. How should receivables representing accounts due in instalments maturing later than one year after date of the bal-

ance-sheet be shown on a statement prepared for seeking a three months' loan from a bank? Give your reasons.

(*American Institute of Accountants, November, 1935*)

226. From the following data:

(*a*) Illustrate the special problems that arise in accounting for instalment sales when the profits are apportioned to income as payments are received.

Total sales per contracts	$100,000
Cost of merchandise sold is uniformly 60% of selling price.	
Down payments received	10,000
Additional monthly payments	30,000
Original selling price of forfeited contracts	5,000
Payments received on forfeited contracts	750
Value of repossessed merchandise	2,500

(*b*) Indicate in journal entry form the proper record to be made for an excessive trade-in allowance. Assume a reasonable allowance to be $100 and the actual allowance to be $200.

(*c*) Discuss briefly the reason for your entry in (*b*) above and its effect on the accounting records.

(*Wisconsin, November, 1937*)

Branches

Domestic Branches

227. Discuss briefly the plan that you would suggest to secure branch-house control on the books of the main office for branch purchases, branch sales and branch cash.

(*Ohio, May, 1933*)

228. State the advantages and disadvantages of a manufacturer billing finished goods to the branch house (*a*) at cost and (*b*) at selling price.

The home office accounts for all purchases and sales of the branch house. However, a small bank account is maintained at the branch, as a petty fund, from which are paid the branch-house expenses. Outline a weekly report which should be sent to the home office for reimbursement of the fund.

(*Ohio, November, 1934*)

229. A manufacturing company having several branch offices carries a general ledger account with each branch and charges goods shipped to them at regular selling prices. At closing periods, these accounts were included with regular trade accounts receivable. Explain how you would deal with such transactions.

(Ohio, October, 1930)

Foreign Branches

230. Company Z operates several foreign branches. For purpose of consolidating the branch accounts with those of the home office in connection with preparation of the annual financial statements, how should you treat the fluctuations in foreign exchange, under the following conditions:

(*a*) If the net result of the year's exchange transactions is a debit?

(*b*) If the net result of the year's exchange transactions is a credit?

(*c*) At what rate of exchange should you value the branches':

1. Net working capital assets.
2. Fixed assets.
3. Periodic remittances to the home office.
4. Income and expense accounts.

(Ohio, May, 1934)

231. The A. Z. Company of Milwaukee opened a branch house in Canada during March, 1931. The branch office maintained books of account, and the results of operations of the branch were to be taken up on the books of the home office at the close of each year. During the year, the rates of exchange existing between the United States and Canada varied considerably. Large amounts of fixed assets were purchased for the branch at various rates of exchange. In your audit report for the year 1931, it is necessary for you to incorporate the results of operations of the branch house with those of the home office and to consolidate the branch and home office balance-sheets as of December 31, 1931.

(*a*) State the basis of conversion (rate of exchange at date of audit, rate at date of balance-sheet, rate at date of purchase or average rate for the period) that you would adopt with respect to each of the following branch-house accounts:

1. Cash.
2. Accounts receivable.
3. Inventories.
4. Fixed assets.
5. Sales.
6. Purchases merchandise.
7. Expenses.

(*b*) If different rates of conversion are used for the foregoing accounts, the branch office trial balance is of necessity out of balance. How should this difference be treated?

(*Wisconsin, May, 1932*)

Insurance

232. What is meant by the following statement: "The net value of the insurable assets at the date of the balance-sheet was $100,000. Fire insurance on these assets in this amount was carried under 80 per cent co-insurance policies?" In the event of total fire loss, what amount would the insured recover?

(*Ohio, October, 1937*)

233. (*a*) Define a co-insurance clause in an insurance policy.
(*b*) A company carried $50,000 insurance. The policy contained a co-insurance clause stating that the insured agreed to carry insurance to the amount of 80% of the value of the company's insurable assets or become a co-insurer. The company had a fire loss amounting to $40,000. The insurable assets at the time of the fire amounted to $100,000. How much insurance is the company entitled to collect from the insurance company?

(*American Institute of Accountants, November, 1935*)

234. State the amount of insurance collectible in each of the following cases when the policies include an 80 per cent co-insurance clause:

Assets	Sound value	Loss suffered	Insurance carried
Buildings	$75,000	$30,000	$62,000
Furniture	20,000	18,000	12,000
Delivery equipment	8,000	3,000	4,800
Merchandise		60%	9,800

To find the value of the merchandise destroyed, the following facts are submitted from which to select the significant data:

The gross profit is agreed to be 30% of sales.
The sound value is the same as the cost.

Purchases for the period	$54,750
Opening inventory	16,360
Return purchases	1,110
Salesmen's commissions and advertising	12,197
Officers' drawing accounts	8,400
Postage and stationery	1,460
Sales	72,000
Credit-department expense	650

(*Wisconsin, May, 1932*)

235. The Brobdingnagian Oil Company is a distributor of gasoline and fuel oils; and because of the large fleets of trucks necessary for the operation of its business, the company carries its own truck insurance (fire and theft, public liability, etc). Monthly estimates are debited to insurance expense and credited to reserve for insurance. Losses are charged direct from cash disbursements to the reserve. You are asked to give your opinion as to the position of the reserve on the balance-sheet. Is it a liability, a part of net worth, or neither?

(*District of Columbia, May, 1931*)

236. (a) When a company carries its own fire insurance should a reserve therefor be provided by a periodic charge to insurance expense, or by an allocation of surplus?

(b) Assuming such a reserve to be ample in amount, in what circumstances would you question its protection?

(*American Institute of Accountants, May, 1931*)

237. State three methods, with your arguments for and against each one, of showing as an investment the premiums paid by a corporation on a policy in its favor on the life of its president.

(*American Institute of Accountants, May, 1930*)

Municipals

238. Name and describe the principal groups in which the financial transactions of a municipality should be summarized in its annual statement.

(*American Institute of Accountants, May, 1931*)

239. (a) On what basis of valuation should the general fixed properties of a municipality be carried on the books? Give reasons for your answer.

(b) Should any different treatment be applied to similar property of utilities operated by the municipality? Give reasons for your answer in this case also.

(*American Institute of Accountants, May, 1936*)

Miscellaneous

240. A manufacturing company has experienced difficulty in the handling of its creditors' accounts, a number of invoices having been paid twice. What general improvements in the system of internal check should you suggest to obviate such errors? You may assume that the operations of the company are sufficiently large to warrant any necessary division of labor.

(*Wisconsin, November, 1935*)

241. Thomas Farthing operates a delicatessen store and a grocery, with the aid of his wife and daughter. He sells for cash and credit and buys for cash and credit but makes no deliveries. The sales aggregate about $30,000 per year. He has a few tables and serves light refreshments also. The store is next to his home, both of which he owns.

He has asked you to arrange a very simple method of bookkeeping which can be kept by his daughter, a high-school graduate. You are to prepare appropriate statements for him at the end of the year. Outline a simple plan for recording his activities which can be kept with the least amount of work, and explain its details for the benefit of your client.

(*Pennsylvania, November, 1931*)

242. An allotment company which has contracted with purchasers to install improvements (*a*) continues to make sales before improvements are completed, (*b*) gives free lots and automobiles as prizes in its sales campaign and (*c*) pays its salesmen's commissions in full out of customers' initial payments. What method of accounting procedure should you suggest to determine annual gain or loss from operations?

(*Ohio, May, 1931*)

243. Outline a system of accounting for business of a general character, using your own type and having gross sales of less than $100,000 annually. Include the names of books and method of recording suggested by you.

(Ohio, May, 1932)

244. In the installation of an accounting system for a corporation owning and operating a large office building, what books and records should you recommend? What safeguards should you provide to insure the recording of all cash receipts from tenants?

(Ohio, May, 1936)

245. Outline a system of accounts for a real estate corporation acting as agent for the rental and management of numerous properties. State the necessary books of account, give a list of the ledger accounts required, describe the cash accounts and discuss what you consider to be the essential features of the accounting without showing any forms or money values.

(Pennsylvania, November, 1931)

246. What is the purpose of a private ledger? What accounts should be carried therein? Draft journal entries to open a private ledger for a manufacturing concern, using your own figures.

(Ohio, May, 1933)

247. Discuss the accounting problems involved in handling expenditures for experimental and research work.

(Wisconsin, November, 1937)

248. (*a*) What is meant by the "natural business" year in an industry?

(*b*) From the following postclosing trial balances for the Showhow Company at the close of two different months, select the one that in your judgment reflects the end of the natural business year, and prepare therefrom a balance-sheet.

Cash	$ 42,816		$ 11,262	
Notes receivable	5,000		21,000	
Notes receivable discounted		$ 4,000		$ 16,000
Accounts receivable	37,149		62,374	
Reserve for bad debts		1,850		3,100

Merchandise inventories	$ 49,368		$ 96,985	
Plant and equipment	131,640		131,640	
Reserve for depreciation		$ 26,201		$ 27,482
Goodwill	100,000		100,000	
Prepaid expenses	400		375	
Notes payable		15,000		20,000
Accounts payable		21,577		58,653
Bonds payable		75,000		75,000
Capital stock		100,000		100,000
Surplus		122,745		123,401
Totals	$366,373	$366,373	$423,636	$423,636

(*c*) State (do not discuss) three advantages of closing at the end of the natural business year.

(*Wisconsin, May, 1932*)

249. On what basis should the production budget be determined? A manufacturer's estimate of units required to meet sales deliveries for the current year totaled 150,000. At the beginning of the year there were 20,000 units on hand, and it is desired to have 25,000 units on hand at the close of the year. What quantity would have to be produced to meet the budget requirements?

(*Ohio, October, 1937*)

250. How should you distribute the administrative overhead to each department of a college in the preparation of its yearly budget? Would the budget be prepared on the basis of accrual or cash receipts and disbursements? How should you handle the cost of room and meals given to employees as part of their compensation?

(*Ohio, May, 1935*)

251. Certified public accountants are aware of the unmistakable trend from accounting by manual pen methods to accounting by machine methods. Explain briefly two types of accounting machines, giving the characteristics of each according to the work that it is especially designed to perform.

(*Ohio, November, 1934*)

252. A finance company is considering two plans for discounting automobile notes, as described on page 556. Which plan

is more advantageous to the company, and what is the annual rate of return to the company on its average investment under each plan? (Based on selling price of $3,200.)

Plan 1. On the date of sale, the company receives a down payment of $640, a service charge of 6 per cent ($192) and 10 serial notes, due $320 per month for six months and $160 per month for four months thereafter without interest. Ninety-five per cent of the selling price is paid to the sales agency immediately, and 5 per cent is paid on the date of maturity of the last note.

Plan 2. Same as plan 1, except that service charge is 5 per cent ($160) and six serial notes are received, due $426.70 in one month and $426.66 monthly for five months thereafter.

(Pennsylvania, November, 1931)

253. The Y Corporation, a retail house, discounted $123,400 of its sales contracts with a finance company under the following terms: service charge of 8 per cent of face value, and 10 per cent withheld as a cash reserve. Each contract is supported by a series of eight 6 per cent interest-bearing notes of equal amount, all dated on the day they were discounted with the finance company. The notes mature quarterly over a two-year period. The cash reserve is to be refunded proportionately as and when each contract is paid in full by the Y Corporation's customers. What saving would the Y Corporation have effected by using these contracts as collateral at the bank for a 7 per cent two-year note, the principal to be reduced quarterly by the amount of the paid-up contract notes, including interest, assuming the loan to be for $101,188 and that all contract notes will be paid promptly at maturity?

(Ohio, November, 1933)

254. A sales manager gives you the following figures relating to a household device and asks you to determine the amount of working capital that he will require to finance his business:

Product X is the only item sold.

Selling price	$100 each
Cost	50 each
Selling expense	20 each
Overhead	10 each
Net profit	20 each

Estimated sales:

1st month	40 units
2d month	60 units
3d month	75 units
4th month and each month thereafter	100 units

Sales are to be made on the basis of $10 down and $10 monthly. The cash outlay at the time each unit is sold is $80. In your solution show the amount of working capital required each month until the maximum working capital requirements are met.

(Wisconsin, November, 1934)

AUDITING QUESTIONS

AUDITING QUESTIONS

Verification of Cash

1. Outline a complete program for a cash audit.

(Ohio, October, 1937)

2. Describe *briefly* the minimum procedure with which you would be satisfied for the audit of the 54 commercial checking accounts maintained by a manufacturing company in different sections of the country.

(District of Columbia, May, 1936)

3. What are the primary purposes of a second bank reconciliation, i.e., a reconciliation of the bank balance as at some date during the auditor's examination subsequent to the reconciliation made as at the balance-sheet date?

(American Institute of Accountants, November, 1937)

4. The Popular Department Store of Philadelphia has "cash on hand and in banks—$136,540.25" at the close of its fiscal year, August 31, 1936.

Describe the procedure and steps to be taken

(*a*) In making a complete verification of this cash.

(*b*) And in auditing the cash receipts and disbursements for the year.

(*c*) Prepare a set of instructions for a suitable "internal check" on cash for use in this store in the future.

(Pennsylvania, November, 1936)

5. On March 6, 1933, you start an emergency audit of the A. B. Company and you are required to render a certified balance-sheet as of that date. You find the cash on hand to consist mainly of cheques drawn on banks all over the country in payment of accounts receivable which have been duly credited by the bookkeeper. By proclamations of the president and governors of states all the banks involved have been closed, and you have learned from confidential sources that only sound banks will

be permitted to reopen. Your client's own bank is regarded as perfectly sound. Given full power by your client to use your own judgment

(a) What instructions will you give the bookkeeper?

(b) How will you treat the items of cash and accounts receivable on the balance-sheet in giving an unqualified certificate? Give your reasons.

(*American Institute of Accountants, November, 1933*)

6. State your opinion, and the reasons supporting your opinion, on the following questions pertaining to a test audit, recalling that the time spent on each audit engagement must be kept as low as possible:

(*a*) Should the endorsements on returned paid checks be examined?

(*b*) Should the sequence of check numbers be accounted for?

(*c*) Should any verification be made of cash transactions of the month following the audit date?

(*d*) Is it necessary to compare disbursements charged to accounts payable in the cash book with the credits to accounts payable in the voucher record?

(*e*) Is it necessary to confirm bank deposits appearing in the bank reconcilement as at the audit date?

(*Pennsylvania, November, 1931*)

7. The cashier of a company concealed for several years a defalcation of $10,000 by the following process: on December 31 of each year he deposited in C Bank a check for that amount drawn on D Bank. He would charge C Bank on that date but credit D Bank several days later. How would proper auditing procedure have detected the fraud in an examination as at December 31?

(*Wisconsin, November, 1935*)

8. Explain how you would proceed to discover irregularities in cash payrolls when it is suspected that the following conditions exist:

(1) Employees released have been continued on payrolls for one or more weeks beyond date of release.

(2) Wages paid to casual labor through paymaster's cash fund have been reimbursed to paymaster twice—once by reimburse-

ment of payments made out of the paymaster's cash fund and again through the usual payroll channels.

(3) Wages not claimed by employees have been misappropriated by the paymaster.

(*American Institute of Accountants, November, 1937*)

9. A company's bookkeeper submitted a statement for credit purposes, and you were asked to verify the assets and liabilities with ledger balances. You found the following cash accounts: on hand, $300; cash in First National Bank, $5,500; overdraft Second National Bank, $800. These accounts were shown in one item as cash on hand and in bank, $5,000. What position should you take? Suppose the cash in First National Bank were $300; would your procedure be different?

(*Ohio, May, 1932*)

10. In the auditing of a small corporation, in which all the stock is closely held, you find that 80 per cent of the company's assets is represented by an account termed cash in vault, the vault being in the name of the president of the company, and that the cash has been put in the vault by him temporarily because of the banking crisis. He does not wish the balance-sheet title for this cash to be qualified by any comment to the effect that the funds are in his custody. Should you acquiesce to his wishes in the matter?

(*District of Columbia, May, 1933*)

11. The owner of the Hanover Hardware Company, a large hardware store, suspects an employee of defalcation. He engages you to make a limited investigation, primarily for the purpose of discovering whether or not his suspicions are justified. You find that the employee has charge of the accounts receivable detail over which no control is kept in the general ledger, also that he has access to the cash drawer in which proceeds of cash sales are kept. No one individual has exclusive charge of cash receipts and no attempt is made to deposit the total receipts each day, deposits being made from the cash drawer in even hundreds of dollars whenever deemed advisable by the manager. All checks received from customers, however, are to be deposited the day received. State two steps which you would take to aid you in forming your opinion.

(*American Institute of Accountants, November, 1937*)

12. You are called upon to audit the books of a corporation, the assistant controller of which is in complete charge of all cash transactions and of the bookkeeping records. He has been known to you for years as a man of high standing and unblemished reputation, and it is through his good offices that the audit has been assigned to you.

Your first step is to request authority for the immediate examination of the cash and accounts of the individual cashiers. The assistant controller states that these accounts are regularly examined by himself or one of his assistants, that no need exists for you to examine them, and that you have his personal assurance that all such accounts and funds were correct at the beginning and the end of the period under review.

What would you do in such circumstances?

(*American Institute of Accountants, May, 1931*)

13. The cash receipts of the A Company are not deposited intact, certain payrolls, for example, being regularly paid therefrom. You are now examining the books of the company, this being the first audit to which the books have been subjected.

Cash on hand per general ledger at December 31, 1929, was $1,293.32; and at February 28, 1930, the date of your audit, $1,342.03. At the latter date your count reveals but $1,205.12 on hand which includes a check on account from a customer amounting to $133.34, not yet entered on the books. The cashier is unable to account for the discrepancy and states that the book balance has never been reconciled with the balance on hand.

What steps should you take to trace the difference, and what remedial measures should you recommend to prevent a recurrence of the difficulty?

(*District of Columbia, May, 1930*)

14. On starting a cash audit you are furnished with the treasurer's statement shown below. You find that the daily collections shown thereon are correct and properly entered in the cash book. The daily record of disbursements agrees with the cash book and check stubs. The cash balance does not appear on the books. Undeposited receipts on October 31 aggregated $1,215. You are able to verify the overdraft on October 1,

there being no outstanding checks on that date. The bank statement shows deposits of $18,413.17, canceled checks of $13,118 and a balance of $4,402.16. Checks outstanding on October 31 amounted to $1,835.27.

	Receipts			Disbursements	
Oct. 2	Collections...	$ 416.10	Oct. 1	Overdraft....	$ 893.01
Oct. 7	Collections...	4,892 76	Oct. 8	Checks issued	1,321.78
Oct. 8	Collections...	2,417.29	Oct. 11	Checks issued	5,479.36
Oct. 11	Collections...	6,097.46	Oct. 17	Checks issued	3,804 17
Oct. 19	Collections...	3,866.37	Oct. 24	Checks issued	4,261.51
Oct. 30	Collections...	2,438.19	Oct. 30	Balance......	5,759.34
Total...............		$21,519 17	Total.	....	$21,519 17

Prepare in schedule form a complete report to your client of the results of your investigation.

(Ohio, November, 1931)

15. A company, whose general office is in New York, maintains bank accounts in which receipts are deposited and from which disbursements are made, in the usual course of business, at Bank A, located in New York, and Bank B, located in Chicago. The general office procedure relating to cash disbursements requires, among other things, that invoices and payrolls be approved by the department heads concerned, and that checks be signed by the cashier and countersigned by the office manager. It is also the practice for the cashier to receive the monthly bank statements, reconcile the bank accounts and turn over the bank statements, canceled checks and other memoranda to the office manager, who chëcks the reconcilements. Protected paper is used on disbursement checks and such checks are serially numbered.

On December 10, 1936, the general office cashier embezzles $5,000 from the company by drawing a check to his own order on Bank A, to which he successfully forges the office manager's counter-signature. No entry of this disbursement is made in the cashbook. On December 31, 1936, the cashier draws a check on Bank B for $5,000 to the order of Bank A, and obtains the office manager's counter-signature by explaining that the check is in connection with a transfer of funds. The cashier deposits the second check in Bank A on December 31, 1936, but makes no cashbook entries for the receipt in Bank A or the disbursement

from Bank B. Upon receipt of the December bank statement from Bank A, the cashier destroys the check paid by that bank which he drew on December 10th. The office manager, in checking the bank reconcilement, does not discover the embezzlement.

You are engaged to make an examination of Company A's accounts for the year ended December 31, 1936, and begin your examination on the morning of January 18th.

(1) What type of defalcation does this case illustrate?

(2) Specify and briefly describe three methods of verifying cash balances and transactions by which this type of defalcation should be detected.

(*American Institute of Accountants, November, 1937*)

16. You are given the following facts relative to cash shortages that have occurred in offices where the system of internal check has been inadequate. In each case you are required (1) to outline the auditing procedure that would enable an auditor to uncover such cash discrepancies and (2) to state what system of internal check would have guarded against their occurrence.

(*a*) In a large manufacturing concern the plant superintendent also had charge of the payroll department. It was the custom for the superintendent to obtain cash advances for employees between payroll dates by presenting to the cashier a slip, signed by himself, showing the names of the workmen for whom the money was drawn and the amounts. The cashier charged the advances direct to the plant-labor account. The superintendent obtained many advances during the month that were not genuine, pocketing the cash so received. He turned over to the payroll department only the records of the genuine advances. The check issued by the cashier on the payroll dates for the total of the payroll checks drawn was also charged direct to the plant-labor account.

(*b*) The cashier of a retail store did not deposit all cash receipts daily. At intervals during the year he abstracted cash from the drawer and at the close of the year was short a considerable amount. On the day the auditor made his appearance, the cashier wrote his personal check for the amount of the shortage and deposited it with the balance of the cash on hand in the bank, thereby causing the total receipts to balance with the total

deposits. The auditor counted the cash that day and obtained a bank statement down to date. The cash in bank reconciled with the ledger balance and appeared to be correct. Two days later the bank returned the cashier's check because of insufficient funds and debited the store's bank account with the amount. The cashier received the check from the bank and destroyed it. The cash drawer remained short by the amount of the check.

(*c*) The bookkeeper and cashier of a gas company misappropriated a portion of the cash received from customers in payment of merchandise accounts receivable. He then withheld the monthly statements from the customers with whose accounts he had tampered until such a time as he could effect an offsetting credit to balance the account. The offsetting credit was usually effected by raising the amount of the office copy of a genuine credit memorandum issued for a price allowance or for returned merchandise.

(*Wisconsin, May, 1932*)

Verification of Receivables

17. State how you would proceed in verifying the accounts receivable of a merchandising concern.

(*American Institute of Accountants, November, 1936*)

18. How should you verify the accounts receivable and the reserve for doubtful accounts of a manufacturer?

(*Ohio, November, 1936*)

19. Your audit client favors verification of notes and accounts receivable by correspondence. The task is large, however, and your client desires to make the verification himself. Another client declines to permit such verification. How should you proceed in each case?

(*Ohio, October, 1937*)

20. State in detail how you would audit and verify the notes receivable of a large trading corporation with several affiliated concerns.

(*American Institute of Accountants, May, 1932*)

21. Outline the procedure that you would recommend where you are called upon to verify by test check approximately 50,000

accounts receivable. You may assume any situation with which you are familiar.

(District of Columbia, May, 1936)

22. C Company from time to time sells its accounts receivable to a discount corporation, with recourse, 80 per cent of the account being advanced in cash. What balance-sheet notations does this call for? How should you as an auditor determine the unpaid accounts at the balance-sheet date?

(District of Columbia, November, 1936)

23. The notes receivable account on the general ledger of a corporation, the books of which you were auditing, showed the following transactions:

	Debits			Credits	
Jan. 1, 1933.	Note of A due Mar. 2	$1,000	Feb. 28, 1933.	First National Bank	$1,000
Jan. 15, 1933.	Note of B due Apr. 15	1,200	Mar. 3, 1933.	Cash A's note......	200
Mar. 3, 1933.	Note of A returned ..	1,000	Apr. 1, 1933.	First National Bank	1,500
Mar. 5, 1933.	Note of C due Apr. 4	1,500	Apr. 12, 1933.	First National Bank	1,200
			Apr. 30, 1933.	Balance...........	800
	Total....	$4,700		Total............	$4,700
	Balance...........	$ 800			

State your procedure in verifying the notes receivable at April 30, 1933, and how your findings would be reflected on the balance-sheet.

Give four sources from which the contingent liabilities of a manufacturing concern may be obtained.

(Ohio, November, 1933)

24. An analysis of the notes receivable account of an Ohio corporation disclosed the following:

1. Collateral notes receivable unmatured.
   (*a*) On hand.
   (*b*) Forwarded to attorneys for collection.
   (*c*) Collateral for notes payable.
   (*d*) Missing.

2. Mortgage note receivable for excess plant properties sold.

3. That notes in the amount of $25,000 had been discounted —$15,000 without recourse and $10,000 with recourse.

What procedure should you follow in auditing the foregoing, and how would these items be classified in your balance-sheet?

(Ohio, November, 1931)

25. The A. B. Corporation lends money to its customers, taking their notes secured by warehouse receipts for merchandise in storage. All these notes, together with the warehouse receipts, are pledged by the corporation to secure bank loans.

What steps should the auditor take to verify the notes receivable at the date of his balance-sheet?

(*American Institute of Accountants, November, 1932*)

Verification of Inventories

26. Why is it ordinarily impracticable for an auditor to assume full responsibility for taking and pricing the inventory? What is the general nature of the responsibility that the auditor can and does properly assume in connection with inventories?

(*Wisconsin, November, 1934*)

27. You are to be responsible for the count of a certain inventory. Outline briefly the general procedure that you would wish to follow.

(*Wisconsin, November, 1935*)

28. What is meant by the "gross profit test" as applied to inventories? Give an illustration of how it is applied, and state its purpose.

(*Ohio, May, 1934*)

29. (*a*) How should you verify the merchandise inventory of a mercantile business?

(*b*) Would your verification differ in any way if auditing such accounts of a manufacturing company?

(*Ohio, October, 1930*)

30. How may an auditor determine whether or not there is raw-material overstock in a manufacturing business where perpetual-inventory records are maintained?

(*Wisconsin, November, 1936*)

31. In auditing the records of a concern some weeks after the taking of its physical inventory, you cannot verify the correctness of the inventory by physical count. You are able to obtain from the management a certificate to the effect that the inventory was taken under careful supervision and was valued at the lower of

cost or market. What further consideration, if any, should you give to the matter?

(*Ohio, May, 1930*)

32. In making a balance-sheet audit of the A B Corporation you have received a certificate, signed by the president and general manager, of inventory amounting to $60,000, which you have tested to your satisfaction as to prices and clerical accuracy. Later before the close of the audit you discover that the corporation has filed an income-tax return showing an inventory of $50,000.

What will you do?

(*American Institute of Accountants, November, 1930*)

33. In making an audit shortly after the close of the year you notice an abnormal increase in inventory during the year. Your client, however, furnishes you with a certificate that the quantity and value of the merchandise are correct. How should you proceed under the circumstances?

(*Ohio, October, 1937*)

34. A manufacturing concern keeps a perpetual book inventory of raw materials and supplies. All accounts of the stock ledger are continuously checked with the quantities actually on hand. This takes place at least once in six months and also when stocks are low and have to be replenished. The date of each count is noted on the stock-ledger accounts and adjustments are made after proper investigation of differences discovered. No physical inventory is taken at the close of the fiscal year.

How will you verify this inventory?

(*American Institute of Accountants, May, 1937*)

35. In your examination of the opening and closing finished-goods inventory of a manufacturing company you find that at the end of 1931 the ratio of factory cost to expected selling price was 65 per cent. At the end of 1932, because of lowered selling prices, lower production, and idle plant, the ratio has become 112 per cent. What steps should you take in determining a better basis of inventory valuation for balance-sheet purposes?

(*District of Columbia, May, 1933*)

Verification of Investments

36. State in detail how you would audit, verify and classify on the balance-sheet securities in which the surplus funds of a corporation are invested.

(*American Institute of Accountants, May, 1933*)

37. In your examination of the collateral loans in a bank, state to what you should direct your attention.

Among the demand loans of a bank you were examining, you found a note signed "The Brown Corporation, by A. W. White, president," and across the face was written "Secured by 100 shares of U. S. Steel Common." The stock was issued to A. W. White. What exceptions should you make, and what suggestions should you offer to the bank?

(*Ohio, November, 1933*)

38. You find in auditing the accounts of the Banner Corporation for the year ending December 31, 1932, that instead of depositing with the trustee the $10,000 required to retire the serial bonds due on October 15, 1932, the check was issued to one of the three officers who acted as agent for all of them in acquiring from the bondholders the maturing bonds at the lowest price possible. The corporation then deposited the redeemed bonds with the trustee, the savings being retained by the officers. The three officers own all the outstanding stock.

What should be your attitude toward this transaction? How should you cover the point, if at all, in the balance-sheet or certificate?

(*District of Columbia, May, 1933*)

39. In verifying investments, you inspect stock certificates which support the books, but they are not in some cases the same certificates as were examined at the time of your previous audit. How should you proceed under the circumstances?

(*Ohio, October, 1937*)

40. You are engaged in auditing the accounts of the American Manufacturing Company, a small corporation, the president owning approximately 96% of the outstanding capital stock. The company had been exceedingly profitable for a number of years and had invested some of its profits in good marketable

securities so that funds would be available for an addition to its plant. Examining the securities you find in place of $25,000 par value of bonds, carried on the books at $20,000, a demand note for $20,000 signed by the president. The minutes of the board of directors show that these securities were lent to the president for his use as collateral to secure some personal transactions which have no relation to the affairs of the corporation. The securities are held by the Manufacturers' National Bank as collateral for the president's personal note, and you have received the bank's confirmation.

How will you show this condition in the balance-sheet and how will you qualify your certificate?

(*American Institute of Accountants, November, 1934*)

41. Following is a transcript of all the items in an "investment" account on the books of the A Company:

April 10, 1929—100 shares of Apex Foundries common stock purchased	$4,826.25	
June 25, 1929—1,180 shares of Southern Sugar preferred purchased	4,748 50	
November 26, 1929—100 shares of Apex Foundries common stock sold		$2,960 00

The fair market value of Southern Sugar stock at December 31, 1929, the date of your audit, as reflected in stock exchange quotations, was $6 per share; in view of this fact the president of the company recommends that the book balance of the account be allowed to stand, since it is less than the market value of the stock remaining. The president explains that the account represented a temporary investment of cash and that in view of this single purpose, appreciation logically offsets depreciation.

Explain (*a*) how you would verify the account and (*b*) what valuation should be placed on the account for balance-sheet purposes.

(*District of Columbia, May, 1930*)

42. The X Company is engaged in lending money on real-estate first mortgages, on which principal and interest are payable in monthly instalments over the life of the mortgages. The company obtains a large part of its funds for loan purposes by issuing "insured mortgage bonds" maturing serially. The principal sources of the company's income are commissions on loans made

and interest on these loans. The principal expenses comprise interest on its outstanding bonds, costs of investigating loans, surety and trustees' fees, office expenses, and amortization of discount and expense on the "insured mortgage bonds."

Interest on outstanding loans and on the "insured mortgage bonds" is regularly accrued by the company, and it takes its commission income into earnings in full during the month in which the loans are made.

You are called upon to make an audit of the X Company in behalf of investment bankers who expect to purchase an additional issue of the company's capital stock and offer it for sale to the public.

Assuming that your audit substantiates in all respects the technical correctness of the figures shown on the books, would you give an unqualified certificate to the resulting balance-sheet? Give reasons for your answer.

(*American Institute of Accountants, May, 1932*)

Verification of Fixed Assets

43. In your initial audit of a manufacturing concern, what should you regard as a satisfactory verification of real estate and allowance for depreciation thereof?

(*Ohio, October, 1937*)

44. What auditing procedure is necessary in determining the proper debits that have been or should have been made in depreciation reserve accounts?

(*District of Columbia, May, 1931*)

45. To what extent should you as an auditor be concerned with permanent asset accounts? Assume that it is your initial engagement, that there have been numerous charges and credits in the accounts and that the officers of the company have submitted to you their appraisal of the property indicating more value than is shown by the books.

(*Ohio, May, 1933*)

46. An analysis of the machinery and equipment account of a manufacturing concern revealed, among others, the following items:

Debits:	
Cost of punch press No. 5	$1,500
Cost of punch press No. 10	3,000
Freight on punch press No. 10	50
Expense of installing punch press No. 10	200
Expense of taking out old punch press	150
Expense of rearranging automatic machines to cut cost of operations	1,000
Purchase of small tools	300
Credits:	
Old punch press No. 5 sold for junk	75
Annual depreciation	2,000

As auditor, what would be your comments with respect to each of the foregoing items?

(Ohio, November, 1933)

47. In order to reduce the burden against its future operations, your client has charged to surplus 50 per cent of its machinery and equipment accounts, reducing its depreciation charges accordingly. It has also followed the practice of providing reserves out of surplus and subsequently charging a portion of its operating expenses to such reserves. What consideration would these matters receive in your audit?

(Ohio, November, 1931)

48. (*a*) In auditing the accounts of a mining company, how should you verify the correctness of depletion charges?

(*b*) The I. Y. C. Mining Company borrowed considerable money from their bankers, secured by real estate mortgage with sinking-fund provisions, and carried the cash held by trustees of the sinking fund as cash in bank. How should you show this item?

(*c*) Should you examine as to the sufficiency of the sinking fund; if so, how?

(Ohio, October, 1930)

49. The client you are auditing has made no provision for depreciation during the current year, for the reason that in prior years its depreciation charges have been excessive. Your investigation discloses the property at the close of the year to be worth in excess of book value, and this is confirmed by an appraisal report. What further consideration should you give the matter?

(Ohio, May, 1930)

50. In making an audit of a recently organized utility corporation, you find an entry on the books, supported by resolution of the board of directors, as follows:

"Franchise, Dr.	$50,000	
To Surplus		$50,000
To set up expenditures by incorporators prior to date of incorporation in connection with securing franchises."		

State what you would do and your reasons therefor.

(*American Institute of Accountants, November, 1932*)

51. The Retail Hardware Corporation purchased on December 31, 1930, a cash register for $1,500, paying $500 down and giving a series of notes of $100 each, payable on December 31st of the ten following years. In your audit for the year 1935 you find this item stated in the "cash register" account and on the balance-sheet at $900. The bookkeeper explains that the corporation does not consider the register as its property until all the instalment notes have been paid, although the bill of sale passes the title unconditionally.

(a) State what entries should be made to show the facts. (Assume depreciation at 6%.)
(b) How will they be shown on the balance-sheet?
(c) What explanation will you give the bookkeeper in support of your instructions?

(*American Institute of Accountants, May, 1936*)

52. A certain company has contracted for the construction of a new addition to its factory on a cost-plus basis. Construction starts in October, 1933; and at December 31, 1933, the engineers have estimated that in addition to the payments already made to the contractors, an additional $2,500,000 will be necessary in order that the addition may be ready for occupancy by June 1, 1934. As the company's cash balance is adequate, no financing will be required.

What disclosure do you deem necessary on the balance-sheet prepared by you as auditor of the company at December 31, 1933? How should you modify your answer if arrangements had been completed shortly after January 1, 1934, to raise the $2,500,000 through an issue of first-mortgage bonds?

(*Wisconsin, November, 1934*)

53. Your client, a manufacturer in a small way, occupies rented land and has signed a lease for twenty-five years which does not contain a renewal clause. On the land he has erected a building having an estimated life of fifty years. On his books you find he has charged depreciation at the rate of 2% per annum.

(a) Will you approve this rate?
(b) Would you approve it if the lease had contained an option to renew for twenty-five years longer?

Give your reasons for both answers.

(American Institute of Accountants, May, 1936)

54. A real estate company's principal asset consists of a large number of land contracts receivable from the sale of lots. Most of the lots were sold several years before the date of your examination, and during the intervening period the selling price of similar lots has decreased approximately 60 per cent. How should you proceed to determine the probable realizable value of these land contracts?

(Ohio, October, 1937)

55. You are auditing the accounts of the XYZ Company. You find that, during the year under audit, all fixed assets have been written off against earned surplus. The officers inform you that, in former years, all profits had been invested in plant and equipment and that at the present time, with a decreased production program, only half of the plant capacity is required. In view of the fact that they have a substantial earned surplus, they deemed it advisable to write off the fixed assets, thereby reducing the surplus available for dividends and increasing the net profits through decreased depreciation charges. In subsequent years it is planned to charge off annually to expense all additions, repairs and replacements to fixed assets. Prior to the write-off, the depreciation charge was quite substantial, and it is evident that the amount of the additions, repairs and replacements in subsequent years will be small in comparison with the depreciation charged in prior years.

You are asked to certify to the balance-sheet and income account of the company without reference to the facts that the fixed assets have been written off and that no depreciation has been charged in the profit and loss account.

(*a*) Would you as an auditor be justified in so certifying? Give reasons for answer.

(*b*) If it is your opinion that some reference to the write-off is necessary in your certificate, state what your comments would be.

(*Wisconsin, May, 1932*)

Verification of Liabilities

56. Prepare an audit program to cover the current liabilities of a manufacturing company with which you are acquainted.

(*District of Columbia, May, 1932*)

57. In auditing the books of a concern it is customary to list the accounts payable and to compare the total with the general ledger control. In your opinion, does this prove that all creditors' accounts are included among the liabilities? Discuss.

(*Ohio, November, 1933*)

58. On the books of a manufacturing company you are auditing, you find numerous debit balances in the trial balance of accounts payable. (*a*) How should you satisfy yourself concerning these items? (*b*) In what way might a dishonest employee create such debit balances, and how might he appropriate funds thereby?

(*Wisconsin, November, 1934*)

59. What responsibility should an auditor assume for liabilities that arise or are discovered after the balance-sheet date?

(*Wisconsin, November, 1935*)

60. In auditing the accounts of a corporation you found evidence of attempts to show a more favorable financial condition than the facts warranted. You learned indirectly of the omission of certain liabilities for money borrowed and materials purchased. What investigation should you make to ascertain the true financial obligations of your client?

(*Ohio, November, 1931*)

61. If you were called to audit the accounts of a theater where tickets are reserved and also sold in advance, how should you proceed?

(*Ohio, October, 1930*)

62. One of the duties of an auditor is to ascertain whether or not any liabilities exist which are not shown on the books. What procedure would you follow?

(*American Institute of Accountants, November, 1930*)

63. A public grain elevator receives grain from country shippers and upon receipt issues its warehouse certificates which are considered negotiable. How should you verify outstanding certificates and detect possible overissue of certificates?

(*Ohio, October, 1930*)

64. (*a*) A large publishing house executed royalty contracts with various authors and agreed to pay royalties based on the number of copies manufactured. How should you verify royalties paid or accrued?

(*b*) Is there any special problem involved in evaluating inventories of such a concern?

(*Ohio, October, 1930*)

65. In the accounts of the B Company you discover an item of unclaimed dividends which has been carried in the accounts-payable ledger in a constantly increasing amount over a period of years. On the balance-sheet, the account has always been merged with trade accounts payable. How should you verify the account, and what adjustment or other disposition of the item should you make in your annual audit of and report on the company's accounts?

(*District of Columbia, November, 1936*)

66. In preparing the December 31, 1931, balance-sheet of an advertising agency you find that invoices totaling $12,000, dated during December, for advertising space in various magazines issued during that month, which in accordance with established custom were rebilled to the advertiser's clients as of January 3, 1932, have not been recorded on the books of the advertising agency, and your client refuses to take them up as his liability until 1932. What effect will this have on the certificate that you will attach to the balance-sheet?

(*District of Columbia, May, 1932*)

67. In auditing the books of the A B Company you find an item of $1,000 debited to notes-payable account, but no canceled

note is produced in support thereof, nor can you find a similar amount previously credited to this account. For good and sufficient reasons you do not desire to question the officers of the company until you have more information regarding the transaction.

(a) How would you proceed to obtain that information?

(b) What may you expect to learn?

(*American Institute of Accountants, May, 1930*)

68. In the course of your initial examination of the accounts of the Ideal Stores Company, you ascertain that of the substantial amount of accounts payable outstanding at the close of the period, approximately 75% is owing to six creditors. You have requested that you be permitted to confirm the balances owing to these six creditors by communicating with the creditors, but the president of the Stores Company is disinclined to approve your request on the grounds that correspondence in regard to the balances—all of which contain some overdue items—might give rise to demands on the part of the creditors for immediate payment of the overdue items and thereby embarrass the Stores Company.

In the circumstances, what alternative procedure would you adopt in an effort to satisfy yourself that the books show the correct amounts payable to these creditors?

(*American Institute of Accountants, November, 1937*)

69. A concern, having a large bond issue, under its trust agreement, must retire a certain sum annually. You found that an officer of the company turned over, by journal entry, bonds for redemption at par. The bonds were quoted regularly in the open market. What procedure should you follow to audit such transactions?

(*Ohio, May, 1932*)

70. Certain concerns demand that charges for purchases, services, etc., be made out on their own invoice forms.

(a) What are the advantages and disadvantages of such a policy to the concern?

(b) How does it affect the outside auditor?

(c) What are the advantages, disadvantages and outstanding characteristics of the standard "simplified invoice form" devel-

oped by various associations of purchasing agents? How does it affect the outside auditor?

(*American Institute of Accountants, November, 1936*)

71. An amusement park, operating during the summer months only, sells tickets to the public, good for admission to its various concessions. The tickets are not redeemable in cash but at any time after purchase may be used for admission to the concession and are honored even in the following season.

In making an audit of this amusement park at the end of its season you find that several hundred dollars' worth of these tickets has not yet been turned in and is apparently outstanding in the hands of the public.

How would you show this condition on the balance-sheet of the company?

(*American Institute of Accountants, May, 1936*)

Verification of Net-worth Items

72. Explain briefly the procedure to be followed in verifying the capital stock for the purpose of the usual annual balance-sheet audit.

(*American Institute of Accountants, May, 1937*)

73. A corporation has three issues of stock—A preferred, B preferred and no-par common. The National Bank and Trust Company is registrar for the A preferred. The B preferred is being sold on the instalment plan. The issuance and transfers of the B preferred and the no-par common are made by the corporation. State your procedure in verifying the capital stock.

(*Ohio, November, 1933*)

74. When auditing the books of a corporation, you find that certain officers, who were partners in the business prior to incorporation, have apparently made withdrawals in excess of what the finances of the corporation will allow.

(*a*) How would you proceed in such circumstances and what comments would you include in your report?

(*b*) On what statements in your report would the withdrawals appear and under what classification?

(*Ohio, May, 1931*)

75. What is the auditor's duty with regard to each of the following accounts before certifying to the balance-sheet on which they appear? Where should they be shown on the balance-sheet?

(a) Reserve for depreciation.
(b) Reserve for restoration of leased property.
(c) Reserve for contingencies.
(d) Reserve for bond sinking fund.
(e) Reserve for income taxes:
   1. In the case of an interim balance-sheet.
   2. In the case of a final annual balance-sheet.

(*American Institute of Accountants, May, 1936*)

76. At the conclusion of an audit you find the net worth of your client to be represented by:

Capital stock—2,000 shares	$200,000
Deficit	85,000
Net worth	$115,000

Considering the relative advantages and disadvantages, your client is in doubt whether to (*a*) call in and cancel a portion of the stock or (*b*) reduce the par value of present shares or (*c*) remove the par value of present shares. What should you advise, and for what reason?

(*Ohio, May, 1933*)

77. A corporation reports that it has earned sufficient profits to be able to declare a 6 per cent dividend on stock outstanding but does not have sufficient cash on hand to permit the payment. The directors of the corporation have asked you to audit the books and explain the reason for the shortage of cash.

(*a*) Name the factors that must be considered before the dividend should be declared.

(*b*) Recommend several methods whereby the cash needed can be procured.

(*Ohio, May, 1931*)

78. In a qualified certificate appears the following sentence:

> "Depreciation of capital assets has been charged on the basis of the cost of such assets and not on appreciated values."

In the accompanying balance-sheet surplus is stated as a single item.

Your client, a prospective investor in the stock of the corporation in the case, asks you to explain what the sentence means, and to advise him as to what further information he should obtain.

What explanation and what advice would you give him?

(*American Institute of Accountants, November, 1931*)

79. The E. Z. Corporation issued $100,000 of preferred stock with an obligation to set aside a certain percentage of its annual profits as a reserve for the final redemption of the stock at par, a corresponding fund being accumulated in actual cash. It is further provided that the corporation may use this cash to repurchase its preferred stock in the market, carrying it as treasury stock until redeemed. Such redemption may take place at any time on due notice to the holders.

In the course of time the corporation has set up such a reserve and cash fund to the amount of $50,000. In 1932, owing to the depression in the stock market, it was enabled to buy in the entire issue at an average cost of 10 per cent, or $10,000. Thereupon, after giving "due notice," it redeemed the entire issue, and its balance-sheet now shows cash in the fund of $40,000 and an increase in the surplus of $140,000.

At the annual meeting, which you attend as auditor, you are asked if this additional surplus is available for an extra dividend on the common stock.

What would you reply? Give your reasons.

(*American Institute of Accountants, May, 1933*)

80. The Y corporation was originally capitalized at nine million dollars as follows:

50,000 shares preferred stock, cumulative, $100 par	$5,000,000
400,000 shares common stock, no-par, stated value $10	4,000,000

At the beginning of 1931 it had an earned surplus of $500,000, but during the year it suffered an operating loss of one million dollars.

To avoid showing a deficit at the end of the year, the corporation induced its preferred stockholders to exchange their shares

of par stock for an equal number of no-par shares with a stated value of $50 each, the new stock retaining all the guaranties of the original as to dividends, liquidating value and callable value.

After sundry intangible and doubtful assets had been written off, the corporation's balance-sheet as of December 31, 1931, showed (in totals):

Total assets	$9,000,000	Total liabilities	$1,500,000
		Preferred stock	2,500,000
		Common stock	4,000,000
		Surplus	1,000,000
Total	$9,000,000	Total	$9,000,000

Was this procedure in accordance with sound accounting principles? Would you give an unqualified certificate to the balance-sheet as stated? Give reasons for your answer.

(*American Institute of Accountants, May, 1932*)

Verification of Profit-and-loss Items

81. State briefly the method of verifying the income from bonds and stocks in an investment-trust company.

(*American Institute of Accountants, May, 1931*)

82. How should you verify the item of royalties received?

(*Wisconsin, November, 1936*)

83. (a) State at least three methods by which sales records may be falsified.

(b) What steps would you take to detect them?

(*American Institute of Accountants, November, 1936*)

84. Criticize the following description of the verification of income in an audit report:

"Cash received from the rental of boats by the hour or day has been verified from the daily appointment schedules kept by the dock tender (and not by the bookkeeper or cashier). All other receipts for monthly rentals, berth privileges, etc., are received in the form of cheques by mail. As daily receipts recorded agreed with deposits as shown by bank statements, we accept as correct the original entries for these revenues as found in the journal."

(*American Institute of Accountants, November, 1931*)

85. When auditing the accounts of a contractor, you find that an estimated profit on all uncompleted contracts according to their statement of completion has been carried to profit and loss. What is the auditor's duty in such case?

(*Ohio, October, 1930*)

86. The president of a certain manufacturing corporation is suspected of inflating the profits of the company, owing to the fact that his compensation is a percentage of net profit. Outline a number of methods by which inflation might have been effected, and state what steps you would take to disclose them.

(*District of Columbia, May, 1931*)

87. The payroll records of a corporation were as follows: employees' clock cards; employees' piece-rate books; payroll book; payroll checks, payable to order; payroll-distribution record; bank payroll account. The paymaster and his assistant take care of all the payroll work. How should you audit the payroll?

(*Ohio, November, 1933*)

88. In an organization that you are now auditing and that pays certain officers a bonus based on net profits, what accounts should be given particular attention to prevent manipulation of the current year's earnings? State six methods by which these accounts might be altered so as to affect net profits.

(*District of Columbia, May, 1932*)

89. How should you determine the amount of a bonus for the year 1929 payable to an employee of a corporation on the basis of 10 per cent of net profit, assuming that the corporation's taxable income was in excess of exemptions allowed? Give an example.

(*Ohio, May, 1930*)

90. In the examination of a coal-mining company in which agents manage the mine operations and sell the coal, for which services they are paid on the basis of tonnage sold, you have been asked to make a particular check of the compensation paid during the year. How would you verify the tonnage sold?

(*American Institute of Accountants, November, 1937*)

91. How should an auditor verify the book record of:

Directors' fees.
Officers' salaries.
Commission paid to officers.
Officers' traveling expenses.
(*American Institute of Accountants, May, 1936*)

92. What steps should you take to satisfy yourself that your client, a manufacturer of steel stampings, is receiving all income accruing from the business and that all expenditures have been made for the benefit of the business?

(*Ohio, May, 1930*)

Auditor's Certificates

93. What is the value of a balance-sheet that bears only the signature of the auditor without any accompanying certificate? What is your opinion of such a statement?

(*American Institute of Accountants, May, 1932*)

94. What is meant by a qualified certificate? Outline a situation where a qualification would be necessary, and indicate the qualification that you would require.

(*Wisconsin, November, 1934*)

95. Prepare the form of auditor's certificate that you consider appropriate for that portion of your audit relating to inventories. You are informed that a physical inventory was taken on December 31; and detail sheets listing the quantities and prices, claimed to be cost or market—whichever is lower—are submitted for your use. Your examination is being made about March 15.

(*Ohio, May, 1933*)

96. If no physical inventory at the end of the year is submitted to you in support of book figures, should you feel justified in making an unqualified certificate on a balance-sheet for a large manufacturing company which uses a standard cost system in its factory—a system that, in the course of your audit, you have determined to be accurately and competently handled?

(*District of Columbia, May, 1931*)

97. State your reasoned objections to the form and the substance (a) of the various numbered parts of the following certificate and (b) of the certificate as a whole:

AUDITORS' CERTIFICATE

(1) We have audited the books, accounts and records of Adam & Smith, Inc., as at December 31, 1935, and (2) certify that, (3) subject to the realization of the accounts receivable and the inventories, (4) the attached balance-sheet is a true and correct statement of the company's financial position for the year. (5) We further certify that the accompanying profit-and-loss account as at December 31, 1935, is (6) true and correct according to the books.

JONES, BROWN & CO.

(American Institute of Accountants, May, 1936)

98. The Indiana Brewery Company was incorporated April 5, 1933, with an authorized capital stock of 2,500 shares of $100 par-value stock. Payment has been received for 250 shares at par, and the remainder of the shares are to be sold at $150. An option has been secured from the owners of a brewery for the purchase of the plant for $250,000 cash. The plant has recently been appraised at a sound value of $375,000.

Officers of the brewery company are required to submit a certified balance-sheet in order to obtain a brewery license. They desire to secure the license before proceeding further with the sale of stock and purchase of the plant and have employed you to prepare the balance-sheet and certificate to be used in the license application. Based on facts stated, prepare balance-sheet and certificate.

(Ohio, May, 1933)

99. The American Institute of Accountants has suggested and the New York Stock Exchange has adopted the following form of report to be used instead of the ordinary "short certificate," viz.:

ACCOUNTANTS' REPORT

"To the XYZ Company:

"We have made an examination of the balance-sheet of the XYZ Company as at December 31, 1933, and of the statement of income and surplus for the year 1933. In connection therewith we examined or tested accounting records of the company and other supporting evidence and obtained information and explanations from officers and employees of the company; we also made a general review of the accounting methods and of the oper-

ating and income accounts for the year, but we did not make a detailed audit of the transactions.

"In our opinion, based upon sucn examination, the accompanying balance-sheet and related statement of income and surplus fairly present, in accordance with accepted principles of accounting consistently maintained by the company during the year under review, its position at December 31, 1933, and the results of its operations for the year."

Compare the above form with the ordinary "short certificate," and state what advantages, in your opinion, it has over the latter.
(American Institute of Accountants, May, 1934)

100. The following certificate was appended to the consolidated balance-sheet of the Blank Corporation and its subsidiaries:

We have examined the books and accounts of the Blank Corporation and its domestic and South American subsidiaries and affiliated companies for the year ended December 31, 1929, and have had submitted to us the audited statements of the remaining foreign subsidiary companies. The assets and liabilities of subsidiary companies other than the South American companies are embodied in the above balance-sheet. South American and affiliated companies are treated as investments. In accordance with the decision of the directors, no charge for depreciation of plants was made during the year. We certify that upon the foregoing basis the balance-sheet is in our opinion correctly prepared so as fairly to set forth the financial position of the companies at December 31, 1929.

What qualifications are there in the above certificate?
(American Institute of Accountants, November, 1930)

Ethics

101. In the code of ethics of the American Institute of Accountants it is provided that no member shall advertise his professional attainments. Explain the principle underlying this rule.
(American Institute of Accountants, November, 1933)

102. What exceptions to the rule of professional secrecy about facts discovered in an audit can you mention? Explain.
(American Institute of Accountants, November, 1936)

103. The A B Corporation offers you an engagement to make a detailed audit of its books and accounts, your fee to be paid in

stock of the corporation at par. For some time the stock has been quoted above par on the local exchange.

State whether or not you would accept such an engagement, and why.

(*American Institute of Accountants, November, 1935*)

104. You have audited the accounts and certified the balance-sheet and earnings statement of the X Corporation for the year 1933. In 1934 the president of the corporation, knowing that you are suffering from lack of employment, offers you the privilege of selling a block of its stock on a commission basis. As a professional accountant will you accept the offer? Give your reasons.

(*American Institute of Accountants, May, 1935*)

105. (a) Your client, who owes money to his bank, has given the latter your annual report. The bank asks you for additional information. What will you do? Give reasons.

(b) You are asked to audit the accounts of a company which had thus far been audited by another accountant in good standing. Will you accept the engagement? Give reasons.

(c) At a meeting of the alumni of your college it was decided to found a scholarship. You agreed to contribute 15% of all the fees collected for work given you by the alumni or through their efforts and considerable business came your way in that manner. You are accused of unprofessional conduct. State your defense.

(*American Institute of Accountants, May, 1937*)

106. You are making an audit of the X Corporation, among whose assets you find stocks and bonds of the Y Company of a substantial amount. In support of their value you are offered a balance-sheet of the Y Company certified by a fellow member of the American Institute. After careful study of this balance-sheet you are convinced there are serious errors in it and you can not conscientiously accept it. You explain the matter and point out the doubtful items to the officers of the X Corporation, whereupon, after securing the consent of the Y Company, they instruct you to make an audit of the Y Company also.

Bearing in mind the provision in the Institute's rules of professional conduct—that no member shall encroach upon the business of another member—what will you do? Give your reasons.

Also state your understanding of the meaning of this provision of the rules.

(*American Institute of Accountants, November, 1934*)

107. You are in public practice, with a large staff, and assign a senior with assistants to make a detailed audit of Company A. You are also called by Company B for a similar engagement. The men assigned to the audit of Company A, in checking sales invoices to Company B, discover an error of $99 under charge in the extension. The men assigned to the work on Company B, however, did not discover the error, and the men working on the books of Company A did not know that other staff men were likewise engaged on the books of Company B. The report of Company B was submitted to the client. The error was brought to your attention. What would your procedure be?

(*Ohio, May, 1932*)

Consolidations

108. Entering upon an audit of the A B Company you are handed the general books of account and a trial balance thereof. You learn that the company owns all or a controlling amount of the stock of several subsidiaries, carried on the books at cost. The trial balance shows open accounts with each of the subsidiaries.

State what influence this knowledge would have upon you, and why, in respect to

(a) Proving the accuracy of the trial balance.
(b) The steps you would take.

(*American Institute of Accountants, May, 1930*)

109. You are auditing the accounts of the Smith Corporation for the year 1931, and ascertain the following facts:

(1) The Smith Corporation owns a one-half interest in the Jones Corporation, which manufactures parts used by the Smith Corporation in its products.

(2) The Jones Corporation had been highly profitable up to December 31, 1928, and has accumulated five million dollars in earned surplus, but in 1931 it earned only $25,000.

(3) Up to December 31, 1930, the Jones Corporation had never paid any dividends to its stockholders, but in 1931 it declared and paid two million dollars out of its surplus.

(4) The Smith Corporation credited its dividend from the Jones Corporation to current earnings, and its profit-and-loss statement for the year 1931 shows the following composite item:

> "Net earnings for the year to Dec. 31, 1931, after deducting discounts, allowances, cost of sales, depreciation, selling and administrative expenses, and after crediting discounts and miscellaneous income.............................. $500,000"

(a) Would you or would you not certify this statement? Give your reasons.

(b) If not, then give two modified statements, either of which you would be willing to certify.

(*American Institute of Accountants, November, 1933*)

Decedents' Estates

110. The executor of an estate has been charged by a creditor of the estate with misappropriation of assets. The executor retains you to audit his accounts, and you find him short certain assets, but he denies their existence. (*a*) What action should you take in the matter? (*b*) To whom must you report your findings? (*c*) What records would be affected by your findings?

(*Ohio, May, 1934*)

111. You are employed by the estate of A, deceased, to audit the books and render a statement of the affairs of the firm of A & B, of which A was a member. In the course of your audit you find an item debited to insurance expense designated merely "life-insurance premium." On inquiry you learn from the bookkeeper that it was paid on a joint-life policy of the two partners. You find no record of the receipt of the face of the policy.

What does this suggest to you, and what steps will you take in the matter?

(*American Institute of Accountants, November, 1931*)

112. You are instructed to make the first audit of the accounts of an estate covering a period of two years from date of decedent's death. His assets comprised bonds, stocks, mortgage notes, notes and accounts receivable and cash. At the same date there were direct liabilities consisting of notes and accounts

payable and contingent liabilities in respect to notes payable endorsed by decedent, who, however, was not engaged in business.

You find that appropriate investment records and ledger accounts have not been kept, that journal entries without explanations have been made in the cashbook, and that the final cash balance in the cashbook is not in agreement with the balance shown by the bank statement.

State what audit procedure you would follow in verifying the gross and net estate, and the gross and net income of the estate for the two-year period under review.

(*American Institute of Accountants, November, 1931*)

Branches

113. In auditing the books of a manufacturing concern having branches in various cities, you found that the main-office cash control of Branch A amounted to $15,000. Your count of this fund at the branch on the morning of July 1, 1933, revealed the following:

Receipted invoices for June purchases	$ 6,000
Cashier's bank account balance	2,000
Personal check of branch manager	400
Personal check of cashier	600
Personal check of a person unknown to you, dated 6 months prior to your count	300
Cash in drawer	700
Total	$10,000

How should you treat each of the preceding items and the difference of $5,000 between your count and the control in your audit and report for the year ended June 30, 1933.

(*Ohio, November, 1933*)

114. Having received letters from several local customers questioning statements of account rendered them, your client engages you to make a detailed audit of the branch store from which the statements were sent. You direct a senior to make the audit after informing him of the circumstances. He finds in the course of a week many discrepancies for which the local cashier, who also keeps the books, offers vague and unsatisfactory explanations. At the close of a day the senior "as usual" (he says) puts all his working papers in his brief-case, which he locks and places in the store safe. The next morning he finds the

office in confusion, the safe looted, and his brief-case gone—likewise the cashier. Several pages have been torn out of the cashbook, and the customers' ledger has disappeared. All this is reported to you and you take personal charge.

(a) Will you complete or retire from the audit?
(b) What fees, if any, will you charge your client?

(*American Institute of Accountants, May, 1930*)

115. The Dimenslot Company maintains a branch office in a distant city where the only financial transactions authorized are the collection and banking of receipts from automatic vending machines, the payment of branch payrolls and expenses, and the remittance to the factory of funds in excess of branch requirements. Monthly reports of cash receipts and disbursements are sent to the factory.

As auditor you send to your representative in the branch city twelve monthly reports covering the year under audit with instructions to audit the branch records. In due course you receive a report stating that the monthly reports are in agreement with the books and that the balance in bank has been duly confirmed by the depository. The report also states that the deposits, as shown by the bank statements, exceeded the receipts, and the cheques issued by the branch exceeded the disbursements shown by the books. Such excesses consisted of items of which a list is enclosed without comments, showing in totals the following disbursements:

Bank loans, partly renewals, finally paid in full..	$12,000.00
Cheques to employees..........................	2,000.00
Accommodation purchases for employees... . .	2,088 99

(a) What would these three items suggest to you?
(b) What should be the contra items with respect to each?
(c) What criticism would you make of your representative's report?
(d) What further steps, if any, would you take in the matter?

(*American Institute of Accountants, November, 1933*)

116. In the audit of a corporation with foreign branches, what treatment should you accord assets in countries where restrictions have been placed upon removal of funds?

(*Ohio, May, 1936*)

117. You are auditing the books of a company incorporated in the United States and of its Canadian subsidiary company for the year 1931. You find that the accounts of the subsidiary have been consolidated with those of the parent company on the basis of par of Canadian exchange throughout the year, in spite of the fact that the Canadian dollar has been below par most of the year, and was 83% of the U. S. dollar on December 31, 1931.

(a) Should any exchange gain or loss be recognized? If so, should it be reflected in the consolidated accounts?

(b) Upon what basis should the conversion of fixed assets (including the credits to the fixed-asset accounts for property retirements and the provision for depreciation) be made?

(c) Upon what basis would you convert the funded indebtedness, subject to what exception?

(d) Upon what basis would you convert an inventory of goods of the Canadian company purchased during 1930?

(*American Institute of Accountants, November, 1933*)

Banks

118. State how you would proceed in making a detailed audit of a bank.

(*American Institute of Accountants, November, 1930*)

119. Describe how you would proceed in the audit of a bank to verify (a) cash on hand and in other banks amounting to $2,000,000; (b) the collateral loans; and (c) the bank's own investments.

(*American Institute of Accountants, November, 1935*)

120. While auditing an investment bank you learn that the president and treasurer hold similar positions in a savings bank in the same city and have unrestricted access to the securities of both banks.

(a) What would this situation suggest to you?

(b) How would you deal with it?

(*American Institute of Accountants, May, 1935*)

121. You are engaged by the directors to make a balance-sheet audit of the X Bank at the close of 1933. You are expressly requested to refrain from seeking confirmation from depositors

or borrowers owing to public nervousness caused by the recent failure of another bank in the town, the clients of the X Bank being mainly of the working class unfamiliar with auditing procedure.

At the closing hour on December 30, 1933, you appear at the bank and the head bookkeeper hands you the following:

Balance-sheet, December 30, 1933

Assets		*Liabilities*	
Cash on hand	$ 50,000	Notes payable	$ 25,000
Due from banks	80,000	Due to banks	5,000
Stocks and bonds	100,000	Deposits: demand	530,000
Mortgages owned	200,000	" savings fund	420,000
Loans and discounts	600,000	Capital stock	200,000
Accrued interest receivable	10,000	Surplus	100,000
Bank building	50,000	Undivided profits	21,000
Furniture and fixtures	10,000		
Real estate foreclosed	100,000		
Federal deposit insurance	1,000		
Total	$1,301,000	Total	$1,301,000

State how you will proceed to verify the items on the above balance-sheet.

(*American Institute of Accountants, May, 1934*)

Brokers

122. State the method of verifying the following accounts in the audit of a stock-brokerage firm.

(a) Customers' accounts (cash balance and securities).

(b) Failed to deliver.

(c) Failed to receive.

(*American Institute of Accountants, November, 1932*)

123. A man, for whom you are making an audit and financial statement for credit purposes, has an account with a stock-broker which shows:

Stocks purchased on margin	$100,000
Market value of stocks	125,000
Due broker	75,000

Your client requests you to show on his balance-sheet an item of "Stocks, $50,000." What would you do? Give your reasons.
(*American Institute of Accountants, May, 1932*)

124. A grain broker not only buys and sells cash grain but also handles traders' accounts on margins. Assuming that the broker hedges all his cash grain for which he holds warehouse certificates, how should you verify open trades?
(*Ohio, October, 1930*)

125. In making an audit of a stock-broker's accounts you find the following accounts of customers:

(a) Customer Abbot:
Ledger debit balance, $9,500.
Market value of "long" securities held by broker to protect the account, $6,000.
Above account is guaranteed by Customer Brown.
(b) Customers Carter & Davis, joint account:
Ledger debit balance, $75,000.
Market value "long" securities held, $95,000.
(c) Customer Elliott:
Ledger debit balance, $25,000.
Market value "long" securities held, $6,875.
Above account is guaranteed by Customer Flynn, whose debit balance is $88,000, and
Market value of "long" securities held is $191,000.
Elliott also guarantees the account of Gaunt, whose debit balance is $100,000, and
Market value of "long" securities is $60,000.
(d) Customer (1) Harris, and
(2) Harris, special:
(1) Harris' account shows debit balance, $12,500 and "long" securities, $15,000.
(2) Harris', special, account shows debit balance, $2,100. No securities held.

What procedure should be followed in confirming these accounts? Give reason for each case.
(*American Institute of Accountants, November, 1931*)

Insurance

126. What facts should you consider as an auditor in connection with (*a*) life insurance policies; (*b*) fire insurance policies?

(Ohio, November, 1931)

127. Why should an auditor insist upon examining all insurance policies, life, fire, indemnity, and compensation, in the course of his work?

(American Institute of Accountants, May, 1933)

128. A company which you are auditing carries $3,000,000 of insurance on lives of its officers. What verification would you make in connection with this matter and how should transactions for the year and balances at the end of the year be reflected in the accounts?

(American Institute of Accountants, November, 1937)

129. A company has carried as an asset the premiums paid for four different insurance policies on the life of its president. You find that two of the policies name the president's wife as beneficiary, another names his estate and the fourth is payable to the company. The policy naming the company as beneficiary has a loan against it for 50 per cent of the surrender value. The minutes of the company provide that the premiums on the policy to the estate of the president are to be paid by the company for the company's benefit. (*a*) What adjustments are necessary to correct the books? (*b*) What steps should be taken to protect the company and comply with the minutes?

(Ohio, May, 1934)

130. You are auditor for a large manufacturing company which endeavors to carry an adequate insurance coverage of all kinds. Describe the steps and requirements of auditing the insurance accounts and the several insurance policies, and give your comments on the adequacy of insurance carried.

Prepare and set up a classified schedule of insurance policies, such as you would submit with your audit report at the close of the year. Use your own figures and names and classifications.

(Pennsylvania, November, 1935)

131. (*a*) In auditing accounts after a fire how should you proceed to determine the approximate value of the inventory

destroyed, assuming that annual inventories have been taken and the accounting records are available?

(*b*) Of what interest is it to the auditor that a client, at the risk of loss by fire, has carried insurance on only a portion of his property?

(*Ohio, May, 1933*)

132. One of your clients has suffered a fire loss that destroyed all of the inventory and fixtures. None of the office records has been destroyed, and a complete inventory was taken two months prior to the fire. (*a*) Submit your report of the loss, including the method used to value the inventory loss. (*b*) How should you determine the replacement cost of fixtures?

(*Ohio, May, 1934*)

Municipals

133. In the audit of a municipality, what consideration should you give to the carrying value and depreciation of public buildings?

(*Ohio, May, 1936*)

134. You are engaged to audit the accounts of the town of X and also those of the town library, which is being supported partly by public and partly by private funds.

State how you will determine the validity of the expenditures in each case.

(*American Institute of Accountants, November, 1936*)

135. In auditing the annual report of the Town of X you find all the following items of receipts stated under the general head of "Revenues":

1. Taxes received.
2. Loan from Bank of X.
3. Dog licenses.
4. Municipal court fines.
5. Bequest from the estate of A to establish town library.
6. Street assessments collected from owners of abutting property.
7. Permits for parades.
8. Sale of worn-out equipment.
9. Transfer of balance from street opening to street-cleaning account.
10. Deposit by B to cover cost of extra sewer connection.
11. Interest on bank deposits.

12. Donation from C toward repairs on his street.
13. Annual payment under franchise by X Street Railway Co.
14. Fees from town clerk turned in.
15. Rent of city dock to steamboat company.
16. Assessments on members of police force for pension fund.
17. Received from B balance of cost of extra sewer connection (see 10).
18. Newsstand privilege in city hall.
19. Proceeds of paving bonds sold at 110.
20. State grant for up-keep of state highway within town limits.

Re-state these items to show true revenues of the town with titles of proper accounts to be credited; and indicate how the other items should be shown or treated.

(American Institute of Accountants, May, 1932)

Special Industries

136. Donations are received by a hospital from various sources each year. What method should you follow in determining that all donations have been recorded on the hospital's books?

(Wisconsin, November, 1936)

137. (*a*) What accounts should you set up on the books of a building and loan savings bank? (*b*) Explain briefly the accounts peculiar to this type of bank.

(Ohio, October, 1930)

138. Prepare a program for an annual audit of a building and loan association. Also state the character of your report, list the various schedules that you would submit therewith and briefly describe each. Prepare a statement of assets and liabilities, using your own figures; and a statement of income and expenses, using your own figures.

(Pennsylvania, November, 1934)

139. The Rural Coal and Lumber Company operates a retail coal and lumber business in a medium-sized city in Pennsylvania. The annual gross business approximates $400,000, which is about equally divided between coal sales and lumber and building-materials sales. You are to install the accounting records for the company. Furnish a chart of general-ledger accounts. Also an outline of the forms for books of original entry and the general books of the company, and submit details of any supple-

mental records that would be useful, desirable and practicable for a business of this character and size.

(Pennsylvania, November, 1934)

140. (*a*) A real estate concern purchases acreage, develops by grading, paving, sidewalks, etc., and builds houses. In auditing their accounts, you discover that in allocating development costs, the most attractive lots were charged with a greater amount of such costs, even though the less attractive lots were improved to an equal extent. Should you make any changes? Explain.

(*b*) Lots are sold both improved and unimproved. How should you determine the correctness of realized profit, the company having elected to file its income-tax returns on that basis?

(Ohio, October, 1930)

141. The Theatre Company rented films from the Film Company and agreed to pay as rental 15% of the Theatre Company's gross receipts up to a point where it earned a profit (before deducting the rental) equal to one-half of the total rental and beyond that point at the rate of 50% of the gross receipts.

Calculate the film rental for a period in which the gross receipts amounted to $1,000 and the expenses (other than rental) amounted to $400.

(American Institute of Accountants, November, 1934)

142. What special facts should be ascertained and how may they be verified in a detailed audit of accounts of any one of the following:

(a) Automobile dealers.
(b) Stockbrokers.
(c) Farmers.

(American Institute of Accountants, May, 1930)

143. The church of X engages you to audit the books and certify the annual report of its treasurer. You find that the revenues consist of open plate collections, pew rents, envelope pledges, donations and interest from an endowment fund. The expenses are those ordinarily to be found in such cases. A good system of depositing all receipts in bank and making all disbursements by cheque is in force.

Assuming that you find the books correct as far as you can verify them, write a brief report of what you have done, closing with your certificate.

(American Institute of Accountants, May, 1930)

144. Describe a system of accounting and procedure for the Big Cleaning and Dyeing Company to care for and control sales, accounts with customers, collections of work, deliveries of completed work and cash receipts. Explain the forms to be used, but do not rule them up.

Upon investigation you find that their business is divided into three groups, viz.:

(*a*) Cleaning and dyeing for individual customers.

(1) Goods collected and delivered.

(2) Goods left at branch stores.

(*b*) Cleaning and dyeing for tailors whose work is collected and delivered by drivers.

(*c*) Cleaning and dyeing on contract for apartment houses, hotels, clubs, etc.

The terms of service to individual customers are C.O.D. or charge, bills due the tenth proximo, whereas the terms to tailors require payment on Monday for work delivered during the previous week. Contract jobs are subject to special terms. The company operates five branch stores, five trucks for individual customers and 20 trucks for tailors.

(Pennsylvania, November, 1936)

145. You are auditing an importer's accounts in behalf of a bank which has established commercial letters of credit for large amounts in favor of the importer. The latter signs "trust receipts" when he receives the goods he imports.

How far would you pay attention to the practice of the importer in paying the bank drafts drawn under these credits, and why?

(American Institute of Accountants, November, 1931)

146. You are making a balance-sheet audit of a concern whose business is importing and exporting. You find it has been the custom to charge to an account entitled "Freight and charges prepaid" all expenditures of that class on both incoming and

outgoing shipments. At the close of each fiscal period the balance remaining in this account is written off as an operating expense.

A survey of the account for the past five years reveals the following facts:

Year	Debits	Credits	Write-offs
1930	$345,750	$342,000	$ 3,750
1931	298,500	294,700	3,800
1932	253,000	245,500	7,500
1933	258,750	242,000	16,750
1934	268,500	242,500	26,000

All charges are audited and approved by an "auditor," a clerk with a long record of trustworthy service, who neither handles cash nor draws cheques nor signs them.

(a) Discuss this procedure as it relates to the balance-sheet and earnings statement of the periods.

(b) In the circumstances would you consider it necessary or not to bring the matter to the attention of your client? Give your reasons.

(*American Institute of Accountants, May, 1935*)

147. One of your clients informs you that he has purchased a 750-acre farm, including a herd of about 300 head of cattle for $250,000. An initial payment has been made and the deal will be finally closed and settled in about two weeks.

Neither yourself nor your client knows much about farming, but he wants your opinion on important general matters such as advisability of incorporation, farm accounting, taxation, etc., and desires your presence the next morning at a conference where these and other important matters will be dealt with in a preliminary discussion.

State what matters you would look up at your office in the short time available before the meeting. Also prepare notes that will remind you at the conference of the inquiries you wish to make and how to deal with the important questions and problems that will probably come up for discussion and be presented to you. Avoid bringing up questions of detail and confine yourself to matters of general importance.

(*American Institute of Accountants, November, 1936*)

148. You are engaged in February, 1934, by the X Contracting Company, Inc., to advise in connection with the company's accounting system, to make an audit of the company's accounts for the calendar year 1934 and to prepare the federal income-tax return for that year. On your initial visit to the client you find that the company's business consists chiefly of large contracts for road and sewer construction and general excavation, many of which require more than a year to complete. The work is done principally for municipalities, and at the beginning of each month engineers' estimates showing the amount of work completed on each contract during the preceding month are furnished to the company; payment for such work, less a retained percentage provided by the contract, is made promptly. With respect to the company's accounts, you find that in the past a separate general-ledger account has been carried for each contract, this account being charged with all contract costs when incurred and credited with payments received on account of contracts. The debit or credit balances in said accounts are closed to profit and loss at the end of each year.

Discuss the methods of accounting appropriate for this client's business, showing the advantages and disadvantages thereof. Also state whether you approve of the method now used by the client and, if you do, the reasons for your opinion. If you believe that another method would be better, give the reasons for your choice; then outline the method that you would recommend, and give the steps that should be taken to make it effective.

(Pennsylvania, November, 1934)

149. You are auditing the accounts of a restaurant and find that the cost of food supplies is too high in proportion to the receipts from sales.

The restaurant is on the street level of an office building in a busy district of the city. There are four entrances to the restaurant, one on each of three different streets and one from the office building. There is a receiving cashier at each entrance, and cash registers are used. All meals are served at tables and bills are given to customers who make all payments to the cashiers. The kitchen is separated from the diningroom, and two doors are used for service both ways. As the restaurant is open 16 hours daily there are two shifts of employees.

The kitchen manager, who buys all food supplies, contends that the kitchen has issued more meals than have been accounted for in the receipts.

You are asked to suggest a method by which all food taken from the kitchen can be accounted for more exactly. The method suggested must not increase the expense, it must not affect the speed of service in rush hours, and the number of entrances must not be reduced.

What would you suggest?

(*American Institute of Accountants, November, 1930*)

150. The board of directors of a professional school has directed the treasurer of that institution to arrange for an audit of the corporation's books covering the fiscal year ending June 30, 1935; and he has engaged you to do the work. The scope of the audit is left largely to your own judgment. The amount appropriated by the directors to pay for the audit is rather modest. You are expected to render a certified report containing a balance-sheet and profit and loss statement.

The books heretofore have been audited only by committees of directors. The present audit committee has made a partial audit by examining the securities owned and by approving the bank balances at June 30, 1935. The treasurer has prepared his customary annual report comprising a statement of receipts and disbursements. By way of being helpful he has given you a copy of this report with the suggestion that your time would be conserved by accepting the findings of the audit committee respecting the investments and bank balances. His suggestion is that you confine your activities to the verification of the cash receipts and disbursements shown by his report. The treasurer further states that he, personally, is not particularly interested in having you build up a balance-sheet, since none was ever set up before. He also states that the chairman of the board of directors and members of the audit committee have been busy with their own private businesses and therefore hard to contact, so that any questions pertaining to the audit may be taken up with him.

A survey of the records disclosed the fact that the ledger accounts were largely memorandum in nature and that it was impossible to make a trial balance. You found also that the income and expense accounts were on a cash basis. Student

notes for tuition were treated merely as memoranda and not credited to their accounts. Some of the students whose accounts were carried as assets had been out of school three or four years, and the treasurer evidently was very lax in enforcing payment of tuition fees. Inquiry developed the fact that one savings-bank passbook was missing and that a duplicate passbook was being used in its stead. The petty cash was depleted and consisted principally of I. O. U.'s and N. S. F. checks dating back in some instances several years. A memorandum book served as the petty-cash record, and the petty-cash fund was replenished out of current receipts. Loans were made to faculty members, and memoranda attached to their notes indicated that the loans in some cases were used to purchase securities which were held by the treasurer as collateral. Salaries of the faculty members were in arrears as to payment, though the treasurer's cash statement indicated an ample general-fund cash balance.

In addition to the general fund there were a building fund and an endowment fund, the last resulting from proceeds of life insurance policies of deceased alumni. A record of these life insurance policies indicated that additional amounts would be received upon the death of various alumni, and an inspection of one of the policies indicated that the live policies have a cash-surrender value. The building fund was partly invested in real estate which included several residences that were handled by a renting agent.

The school was established in 1920 as a Pennsylvania nonprofit corporation and had approximately 500 students. These agreed to pay an annual tuition fee of $300 and certain extra fees. The principal disbursements were for faculty salaries.

Based upon the foregoing details:

(*a*) Prepare in outline form an audit program which, when entirely checked off by the senior and junior staff members handling the engagement, will enable you to render an audit report containing a minimum of qualifying remarks. In setting up your outline, use as subheadings the various books and records that you would expect to find.

(*b*) Explain briefly the attitude that you have taken in preparing your program in view of the modest fee and of the suggestions offered by the treasurer.

(*Pennsylvania, November, 1935*)

151. You have been engaged to make an audit of a small electric utility which sells both electric current and electrical appliances. One man alone acts as inside manager, appliance salesman, cashier and bookkeeper, and you are informed at the outset that he is suspected of retaining to his own use a few of the amounts collected on appliances sales during the year under review. On making a detailed audit of the cash receipts you find that the manager did, in fact, fail to enter in the cash book cash collections on appliance sales to the extent of $7,500.

The records of the utility are apparently in excellent condition, and all of the supporting data are on file. The general ledger is in balance, and the accounts receivable control account balance is supported by the subsidiary records. Through your investigation you eliminate the electric current accounts receivable which have all been determined correct; and all cash in respect thereto has been properly accounted for. Upon inquiry and investigation you find that the prescribed procedure in respect to merchandise or appliance sales is that regardless of whether the sale is for cash or credit, a merchandise slip is prepared in duplicate, and the copy retained in the office. If the sale is not a cash sale, the duplicate slip is used along with others of a similar nature to serve as the subsidiary record for merchandise accounts receivable, all payments in full or in part being recorded on the duplicate slip. The unpaid balances shown on these various slips at the close of the period covered by your audit totaled the same amount as the accounts-receivable control account balances, and upon contacting the various debtors it was found that the balances were correct in each instance. Nevertheless, as previously stated, many of the payments recorded on the slips were not recorded in the cash receipts record and thus had not been credited to the accounts receivable account in the general ledger.

In the office the normal procedure was to total on an adding machine the several merchandise sales for a given month and to use the total thus obtained as the basis for a monthly entry made directly in the general ledger between accounts receivable and the merchandise sales. The several adding-machine slips are on file, and you satisfy yourself that all of the merchandise slips are on file by reason of your having accounted for all of the merchandise handled.

The manager obviously is short $7,500 in his account, but the shortage is well concealed in the records. In order to be doubly sure, you must locate the concealment. State how you would proceed further to do so, and name at least two possibilities.

(*Wisconsin, November, 1937*)

Examination of Minutes

152. In auditing the books of a corporation do you consider it necessary to examine the minute books? State reasons.

(*Ohio, November, 1936*)

153. (*a*) Do you consider it essential that you have access to the minutes of a corporation's directors' and stockholders' meetings when you are undertaking an audit of that corporation? If so, state why, and state the matters of importance to you that you would expect to find covered therein.

(*b*) Briefly, what should you do if you were refused access to the minute books, assuming that your engagement was arranged by the directors?

(*Wisconsin, November, 1937*)

154. After a stormy stockholders' meeting and quarrels among the directors, you are engaged by the officers of a corporation to make a balance-sheet audit, the first in the corporation's existence of several years. You find the financial records in order and are ready to certify the balance-sheet, but the officers refuse to produce the minute-book for your inspection, offering instead to furnish you with attested copies of such resolutions as you deem necessary to verify certain items.

What will be your attitude in the matter? State your reasons fully.

(*American Institute of Accountants, May, 1934*)

155. You have been engaged by a prospective purchaser to prepare a certified balance-sheet and earnings statement from the books and accounts of a wholesale-clothing corporation.

The minute-book shows that the following officers' salaries were authorized for each of the years 1927, 1928 and 1929:

William Jones, president	$25,000
John Smith, vice-president	25,000
Henry Brown, secretary-treasurer	25,000

An inspection of the salary cheques shows that Jones and Smith received $25,000 each year, respectively. The salary cheques of Brown show that he received $416.67 each month, and that at the end of each year he received two cheques of $10,000 each which he endorsed to Jones and Smith respectively. Questioned, Brown readily admits that his actual salary was only $5,000 a year, although he had reported it as $25,000 in his individual returns, but that Jones and Smith had reimbursed him for the income tax he had paid on income over $5,000.

You call the three officers together and at the conference learn that the procedure outlined above had been adopted in all good faith, on the advice of a public accountant, as a legitimate means of reducing the income taxes of the corporation; that by reimbursing Brown for his income tax Jones and Smith have, indirectly at least, paid what was due the government on the additional amounts they received through Brown; and that anyway the returns of the corporation and of the three individuals, who incidentally own all the stock, have been investigated by an internal-revenue agent and agreements of final determination have been executed under section 606 of the revenue act of 1928 for the three years 1927–1929, although it is admitted that the agent did not discover the facts about Brown's salary.

On being informed of the serious position in which they stand, the officers ask your advice with respect to past returns of the corporation and of the individuals.

(a) Does the above situation affect the balance-sheet you are preparing? If so, how will you show it?

(b) What advice would you give the officers?

(*American Institute of Accountants, May, 1931*)

Miscellaneous Audit Questions

156. Is an auditor responsible for revealing a lack of consistency from one year to another in the application of accounting principles by a company whose accounts he is now in the process of examining?

(*District of Columbia, May, 1936*)

157. In the audit of a large industrial company, to what extent may an auditor rely on the system of internal check maintained by the company?

(*District of Columbia, May, 1936*)

158. To what extent is an auditor on an engagement justified in [illegible] the proffered services of the controller and his assistants?

(*District of Columbia, May, 1936*)

159. State what you understand to be the scope of the following:

(a) Balance-sheet audit.
(b) Complete audit.
(c) Continuous audit
(d) Special audit.

(*American Institute of Accountants, May, 1933*)

160. In making an examination of the accounts of a company which had never before employed public accountants, what special points would you need to cover?

(*American Institute of Accountants, November, 1937*)

161. State the principal objects for which auditors' working papers are made and preserved.

(*American Institute of Accountants, May, 1930*)

162. In auditing the accounts of a corporation for the first year of its existence what records and documents should be examined before starting on the regular books of account? State reason for each step.

(*American Institute of Accountants, November, 1930*)

163. What would be the scope of an audit that you would recommend to a large manufacturing company with a volume of transactions too numerous for detailed verification?

(*Ohio, May, 1936*)

164. The treasurer of a wholesale grocery company brings to your office a trial balance of its accounts, together with a balance-sheet prepared therefrom, explaining that the company cannot afford an audit but desires you to examine carefully the data submitted, so as to certify the correctness of the balance-sheet. How should you proceed, and what form of certification should you use?

(*Ohio, May, 1930*)

165. To what extent is a public accountant liable to a creditor of his client who relies upon his certified statement and suffers a

loss because of a condition existing in the affairs of the debtor-client which was neither disclosed nor indicated in the accountant's report? State your reasons and discuss.

(*American Institute of Accountants, November, 1931*)

166. (*a*) Cash sales in a retail establishment offer a difficult auditing problem from the standpoint of both the internal and the external auditor. Outline an internal procedure that you would recommend as being effective to the management of a store doing an annual business of about $1,000,000.

(*b*) How should your suggested plan facilitate your annual audit of the store's affairs?

(*c*) If your plan has any shortcomings, state the principal one, and make a suggestion whereby the management might protect itself further.

(*Wisconsin, November, 1937*)

167. In making a balance-sheet audit, to what extent should you consider it necessary or advisable to examine transactions other than as of the balance-sheet date? Be specific.

(*Ohio, May, 1936*)

168. In auditing the accounts of a small manufacturing company you find that the sales manager (who is not a stockholder) has a contract with the company which provides that he is to receive, in addition to a stipulated salary, a commission on all the company's sales in excess of $100,000 for the year. The books show net sales of $850,000. You also note that the sales manager acts as office manager, supervising the accounts and the granting of credits.

Under these conditions, what matters would receive your special attention during the audit?

(*American Institute of Accountants, May, 1931*)

169. The president of a company has been in the habit of running the company's affairs under loose and inadequate by-laws, very much as he has seen fit, although in a number of instances he has subsequently sought the approval of the board of directors. As a business advisor you are asked, following an audit, to review certain of his acts in 1932 with the idea of recommending to the board whether its authorization of these acts should precede or follow them. Outline briefly the procedure

that you would suggest in each case so that authority may be properly placed. The acts referred to were:

(*a*) Announcement of future declaration of dividends.

(*b*) Appointment of sales manager who is to be compensated $50,000 per annum.

(*c*) Letting contract for construction of new plant in another city.

(*d*) Dismissal of company's secretary who is also an office employee.

(*e*) Preparation of annual report to stockholders.

(*f*) Repurchase of stock from dissatisfied stockholder at a premium.

(*g*) Accepting business requiring purchase of new machinery.

(*h*) Agreeing to additional assessment of federal income-tax liability.

(*i*) Starting patent-infringement suit against competitor.

(*j*) Sale of unissued or treasury stock.

(*District of Columbia, May, 1933*)

170. The president of a large manufacturing company for which you have become auditor desires that a "daily report" shall be given to him, one that will enable him without too much time or effort to keep in close touch with the company's activities.

Describe what this report should contain. State also by whom it should be prepared and when it should reach the chief executive.

Prepare a sample form of the said daily report, and illustrate it by data and figures.

(*Pennsylvania, November, 1934*)

171. The A. B. Corporation has ten thousand hands employed in some twenty departments. Its payrolls have always been made up by departments in standard form, and hitherto it has had little trouble in ascertaining each employee's total compensation, as changes from one department to another were very rare. In 1932 it adopted a "spread-the-work" plan which involved not only laying off men for short periods but also switching hundreds of them from one department to another as occasion demanded.

Entering on your annual audit engagement February 1, 1933, you find the entire clerical staff working frantically to make out information returns, the number being greatly increased by the

lowering of personal exemptions under the federal income-tax act of 1932. Wages are paid weekly on the hourly basis, so the correct amounts to be returned can be obtained only by tracing each man's time through every departmental payroll.

You are asked to suggest some method by which the data for these information returns may be easily and accurately compiled for the future, without disorganizing departmental cost accounting.

What would you suggest?

(*American Institute of Accountants, May, 1933*)

172. The Securities and Exchange Commission has been urging—in some cases compelling—business enterprises to reveal to investors sales and cost of sales. What are the reasons usually advanced against such disclosures? What is your opinion?

(*District of Columbia, November, 1936*)

173. The regulations of the Securities and Exchange Commission, under the Securities Exchange Act of 1934 and the Securities Act of 1933 as amended, are particularly stringent in their requirements as to the nature and extent of information to be disclosed by the accountants in connection with reports prepared for registration of new security issues, as well as reports to be submitted by companies whose stock is listed for trading on national exchanges.

(*a*) Taking each of the following balance-sheet captions separately, state briefly the nature of the more important disclosures and explanations that you would make in preparing statements and an accountant's certificate for reports intended for the use of the commissions:

Assets

1. Notes and accounts receivable.
2. Inventories.
3. Marketable securities.
4. Subsidiary companies.
5. Treasury stock.
6. Fixed assets.

Liabilities

7. Notes and accounts payable.
8. Bonds payable.
9. Other liabilities.

(*b*) Similarly suggest and discuss several items of a statement of profit and loss to be submitted to the commission.

(*Pennsylvania, November, 1934*)

174. Write the letter of transmittal, certificate and comments for an audit report to the stockholders of the A.B.C. Company. A balance-sheet of the A.B.C. Company is presented, together with information relative to certain assets and liabilities.

Balance-sheet, December 31, 1931

Assets

Current assets:			
Cash on hand and in bank			$ 6,345.50
Accounts receivable—customers			75,839.60
Accounts receivable—officers			15,500.00
Advances to salesmen			7,650 00
Inventories			80,989.50
Total current assets			$186,324 60
Investments:			
Bonds at cost		$ 10,500.00	
Stocks at cost		60,775.00	
Total investments			71,275 00
Deferred assets:			
Unexpired insurance		$ 6,425.90	
Prepaid advertising		20,566 33	
Total deferred assets			26,992.23
Fixed assets:			
Land		$ 50,000.00	
Buildings	$ 76,850 00		
Machinery and equipment	153,925.75		
Total	$230,775.75		
Less reserve for depreciation	94,625.60	136,150.15	
Net fixed assets			186,150 15
Total assets			$470,741 98

Liabilities and net worth

Current liabilities:		
Accounts payable		$ 70,895.60
Notes payable		25,823.50
Accrued labor		5,495.60
Total liabilities		$102,214.70
Net worth:		
Capital stock outstanding	$350,000.00	
Surplus	18,527.28	
Net worth, December 31, 1931		368,527 28
Total liabilities and net worth		$470,741.98

(*a*) Cash on hand consisted of a cash fund of $1,000, included in which were the following items:

(1) Certificate of deposit payable to cashier........	$500.00
(2) A memorandum with notation "postage stamps"	50.00
(3) Receipted expense bills..........	256.50

(*b*) Analysis of accounts receivable as to age:

	Amount
Current..................................	$37,435.60
30 to 60 days...............	10,295.40
60 days to 6 months........................	5,345.60
6 months to 1 year.........................	6,985.70
Over 1 year................................	15,777.30
Total....................................	$75,839.60

(*c*) The accounts receivable from officers represents money advanced to officers for the purpose of meeting obligations incurred by them as a result of accommodation endorsements on notes of a customer of the A.B.C. Company. No change has occurred in this account for the past three years, and it is learned from the officers that the directors of the A.B.C. Company intend to refund this money in the form of a bonus to the officers in a year when the company has substantial profits.

(*d*) Salesmen's advances represents travel advances to salesmen for securing orders for spring delivery in 1932.

(*e*) Bonds and stocks are classified into two groups as follows:

	Cost	Market value
Bonds—listed securities...........................	$ 5,000	$ 2,565
—unlisted securities...........................	5,500	Unknown
Stocks—listed securities...........................	50,775	43,500
—unlisted securities...........................	10,000	Unknown

(*f*) Prepaid advertising represents the cost of advertising expended in the fall of 1931 for the purpose of securing spring business in 1932.

(*g*) Fixed assets are valued at cost.

(*h*) No provision has been made for income taxes payable in 1932 on the 1931 income.

(*i*) As of December 31, 1931, there were unpaid notes receivable discounted with the bank in the amount of $10,350.

(*Wisconsin, May, 1932*)

APPENDIX

COMPLETE C.P.A. EXAMINATIONS

THE OHIO STATE BOARD OF ACCOUNTANCY

THEORY OF ACCOUNTS

Examination, May, 1938

1. Describe
   (*a*) A merger.
   (*b*) A consolidation.
   (*c*) A holding company.
   (*d*) An operating company.
2. Describe
   (*a*) Consolidated balance-sheet.
   (*b*) Subsidiary company.
   (*c*) Negative goodwill.
3. (1) Describe
   (*a*) Capital stock discount.
   (*b*) Treasury stock.
   (*c*) Unsubscribed capital stock.
   (2) How are they shown on the balance sheet?
4. (*a*) Name five legitimate charges against earned surplus.
   (*b*) Name four legitimate charges against capital surplus.
5. (1) Name four intangible assets.
   (2) (*a*) What is the common basis for valuing intangible assets?
   (*b*) Where should they be shown in the balance-sheet?
   (*c*) How should they be amortized? (Use two examples.)

6. You have been asked to set up the accounts for a construction company. Which method of reporting income on contracts would you recommend, (*a*) the percentage of profit on contracts each year or (*b*) the profit at completion of contracts?

7. You have been requested also to recommend the method of reporting bad accounts, (*a*) write-off basis or (*b*) reserve basis. Give reasons.

8. Prepare a proforma balance-sheet for each of the following, showing proper classified groupings:

(*a*) A hospital.
(*b*) A retail department store.

You may illustrate with figures.

9. (*a*) Describe the retail-inventory method.
   (*b*) In what retail businesses would you recommend its adoption?
10. (*a*) List and describe the accounts to be used to record manufacturing expense or burden.
    (*b*) Name two methods for distributing this burden.
    (*c*) What is the meaning of unabsorbed burden?

THE OHIO STATE BOARD OF ACCOUNTANCY

AUDITING

Examination, May, 1938

1. Discuss the duties and responsibilities of a certified public accountant with respect to the basis of pricing, the accuracy of computations, the quantities, quality and condition of inventories.

2. (*a*) Give three examples of internal check and control one may find in accounting for a large manufacturing concern.
 (*b*) Discuss the detailed audit procedure required in each case.

3. In the verification of cash on hand and on deposit as of the close of a fiscal period would the count of cash at date of audit and reconcilement of bank accounts with the bank statements received by the client when canceled checks were returned be all that is required? Discuss.

4. Each month for over a year the bank account on the books of a concern reconciled $2,000 short of the balance per the bank. You were retained to make an audit and were instructed to locate this error. According to the statement received for the month of March, 1937, you found that on the seventeenth the bank had charged $3,300 for checks canceled totaling $5,300. Since the bank had not discovered this error on its books, your client requested you not to mention the matter in your report. What are your duties as an auditor? Would your answer be different if you had made a detailed examination of the books of the bank during this period and had failed to note this error?

5. What records would you examine, and outline the working papers you would prepare, in the verification of the following accounts: (*a*) notes receivable, (*b*) land and buildings, (*c*) unexpired insurance, (*d*) notes payable.

6. In auditing the books of a company for 1937 you found the accounts miscellaneous factory expenses charged with \$10,875.62 and direct labor charged with \$101,642.89. Would you analyze the miscellaneous factory expenses if you were pressed for time in which to complete the audit? Why?

7. A large portion of the income received by a college is derived from its endowment fund. Most of the bequests express certain terms and conditions for which the income therefrom is to be used. The college needs new buildings and additions to the present plant. In order to create a special fund for such improvements, the trustees of the college have set aside periodically income realized from endowment-fund investments. As an auditor of this institution what criticism if any would you offer with respect to this practice?

8. In an audit program the following questions were asked. If you were making the audit state from what source you would seek the answers, and give reasons why the questions were asked:

(*a*) Are bank loans secured by pledge of the company's assets, or by personal endorsements?
(*b*) Are there any contingent liabilities?
(*c*) What procedure is followed to assure company that all shipments are represented by invoice or debit memo?

9. Many certified public accountants include in their audit report a statement of sources and disposition of funds. State the functions of such a statement, and give reasons why it should or should not be included in the audit report.

10. The A Corporation purchased the entire outstanding stock of the B Corporation for \$500,000. Because the net worth of B Corporation was \$400,000, the investment was entered on the books of A Corporation at that value. In auditing the books of the parent corporation and its subsidiary, what recommendations would you make concerning this matter?

THE OHIO STATE BOARD OF ACCOUNTANCY

PRACTICAL ACCOUNTING

Examination, May, 1938

The M Corporation operating under 77-B of the bankruptcy act since June 30, 1937, has, with the agreement of creditors and stockholders, proposed a plan of reorganization acceptable to the court, and a loan has been approved based upon the plan. You have been retained to complete the report giving effect to all the conditions in the plan and the receipt of cash as of December 31, 1937.

Proposed plan of reorganization:

New corporation, incorporated as the N-M Company with the following capital:
Preferred stock: authorization 100,000 shares, par value $10, 5 per cent noncumulative
Common stock: authorization 200,000 shares, no-par value, stated value $1 per share.

The loan, approved in the amount of $500,000, secured by a first mortgage on plant property and equipment, is due over a period of 10 years with 5 per cent interest.

The old preferred stockholders have agreed to purchase sufficient new preferred stock to settle in cash all unsecured creditors' claims at 50 cents on the dollar. For each share of new preferred stock so purchased there will be issued as a bonus one share of new common stock.

The holders of old bonds outstanding have agreed to accept in exchange new second-mortgage bonds of the new company, at dollar for dollar par value, accrued interest on old bonds $120 in cash and 50 shares of new common stock for each $1,000 value of old bonds held.

The creditors with secured claims have agreed to accept 50 per cent in cash and 50 per cent in new preferred stock at par value.

All the accruals are priority claims. All creditors with these claims have agreed to accept 50 per cent in new preferred stock and 50 per cent in common stock at par and stated values, respectively, with the exception of real estate taxes, amounting to $14,000, which must be paid in cash together with interest on old bonds already provided for in the plan.

The old preferred stockholders will receive 10 shares of new common stock for each share of old stock held, plus, in the aggregate, a sufficient number of shares, to be donated to the company, to cover the bonus requirements previously mentioned. There will be set aside for future distribution under a management contract a number of common shares equal to the number of common shares held by the present preferred stockholders after completion of the foregoing.

For the purpose of the new corporation the following adjustment of asset values has been agreed upon after audit.

Provide allowance for doubtful accounts in the amount of $6,000.

Investments have increased in value since June 30, 1937, a total of $15,000.

An appraisal as of June 30, 1937, of plant property and equipment shows reproduction cost new to be $2,400,000 and reserve estimated to reduce the reproduction cost to "sound" value, $1,200,000. The appraisers estimated the remaining life of these assets to be 10 years. Adjust the accounts to give effect to this appraisal and make provision for depreciation to December 31, 1937, acceptable to the Treasury Department for income-tax purposes.

The trustee's certificates are secured by accounts receivable pledged in the amount of $100,000.

The court has ordered the payment in cash of trustee's certificates unsecured, accruals and expense of proceedings along with other payments set forth in the plan. The expense of proceedings was charged to deficit account direct.

Trial balance—December 31, 1937

Cash	$ 40,000	
Accounts receivable	180,000	
Inventories—December 31, 1937	170,000	
Deferred assets	25,000	
Plant property and equipment	1,800,000	
Allowance for depreciation		$1,000,000
Investments	25,000	
Trustee's liabilities:		
Certificates—Unsecured		20,000
Secured		40,000
Accounts payable, trade		35,000
Accruals		70,000
Claims prior to 77-B, June 30, 1937:		
Secured		100,000
Unsecured		400,000
Accruals		75,000
Expense of proceedings (reorganization)		30,000
Bond payable, first mortgage 6%		100,000
Preferred stock, par $100		
Authorized and outstanding		500,000
Common stock, par $100		
Authorized and outstanding		500,000
Surplus-deficit	600,000	
Sales		637,000
Freight, returns and allowances	15,000	
Cost of sales	450,000	
Unabsorbed burden	40,000	
Shipping expense	10,000	
Selling expense	100,000	
Administrative expense	60,000	
Other income		10,000
Other expense	2,000	
Totals	$3,517,000	$3,517,000

You are to prepare:

Journal entries to adjust and close the accounts of the M Company as of December 31, 1937, giving effect to the plan and all disbursements before release from 77-B.

Opening balance-sheet of the N-M Company.

Statement of profit and loss as of December 31, 1937, showing results of trustee's operations and surplus account after all adjustments including the reorganization.

THE OHIO STATE BOARD OF ACCOUNTANCY

PRACTICAL ACCOUNTING

Examination, May, 1938

The Monounit Manufacturing Company produces and sells one product, the monounit.

From the following trial balance at December 31, 1937, after necessary adjustments, you are to prepare:

Statement of profit and loss at standard, showing variances from standard, disregard income tax.

Statement indicating possible causes for each variance from standard (material and labor price variances to be calculated at time charges are made for these transactions).

Journal entries in pencil to open cost ledger at beginning of year and to record transactions for the year.

	Debits		Credits
First National Bank	$ 77,850	Notes payable	$ 120,000
Notes receivable	23,000	Accounts payable	150,700
Accounts receivable	175,150	Accrued taxes	3,000
Inventories, January 1, 1937	210,050	Accrued payroll	4,000
Prepaid expenses	1,750	First mortgage 5% bonds	90,000
Bond discount	11,000	Allowance for depreciation	74,800
Land	145,000	Allowance for bad debts	20,000
Buildings (50-year life)	500,000	Capital stock	800,000
Machinery and equipment (15-year life)	225,000	Surplus	84,700
Office equipment (20-year life)	20,000	Sales, 510 monounits	1,020,000
Delivery equipment (4-year life)	15,600		
Patents on mfg. process Granted January 1, 1937, cost	17,000		
Purchases	236,000		
Direct labor	112,000		
Manufacturing expenses	142,500		
Selling expenses	346,100		
Administrative expenses	104,200		
Bond interest	5,000		
Total	$2,367,200	Total	$2,367,200

The company operates a standard cost system; the cost per unit for 1937 was set on an estimated production of 480 units as follows:

Raw material, 20 lb. @ $25.	$ 500
Direct labor, 400 hr. @ 60c.	240
Manufacturing expenses, 100 machine hours @ $3.50	350
Total	$1,090

The inventories at the beginning of the year were stated at actual quantities and priced at standard as follows:

	Total	Raw material	Work in process	Finished goods
Material	$150,000	$87,500	$37,500	$25,000
Direct labor	24,000	....	12,000	12,000
Manufacturing expenses	36,050	....	18,550	17,500
Totals	$210,050	$87,500	$68,050	$54,500

For the purposes of this problem the valuation of inventories at the end of the year should be consistent with the practice established by the company, but it will be unnecessary to reconcile standard units of production in all cases with standard material and labor charges started into production.

An analysis of the purchases showed that 7,000 pounds were bought at $26 and 2,000 pounds at $27. The direct-labor payroll showed that 180,000 hours were worked at 55 cents and 20,000 hours at 65 cents. No provision for depreciation had been made on the books for 1937.

An analysis of the cost records indicated the following:

	Standard	Actual
Material put into process	10,875 lb.	11,000 lb.
Direct labor for production	201,600 hr.	200,000 hr.
Machine hours for production	49,500 hr.	49,500 hr.
Units completed, 495		
Selling expenses based on net sales	30%	$346,100
Administrative expenses based on net sales	15%	104,200

The $100,000 first-mortgage 5 per cent serial bonds were sold January 1, 1937, for $89,000. The bonds mature at the rate of $10,000 each year, payable on December 31. Prepare a schedule of amortization using the bonds-outstanding method. The portion of discount to be charged off for 1937 had not been entered at December 31, 1937.

THE OHIO STATE BOARD OF ACCOUNTANCY

PRACTICAL ACCOUNTING

Examination, May, 1938

You are to prepare a financial statement of the Marvel Cleaner Company and compute the earnings of the current year, excluding in each case the unrealized profit on instalment sales. Disregard federal taxes.

	Trial balances Before closing, December 31, 1937	Trial balances After closing, December 31, 1936
Cash	$ 142,000	$ 117,000
Accounts receivable:		
1934 sales	35,000	116,000
1935 sales	112,000	278,000
1936 sales	258,000	504,000
1937 sales	810,000	
Due from branches	250,000	230,000
Raw materials in stock	118,000	132,000
Finished and in process inventory December 31, 1936	182,000	182,000
Plant and equipment	450,000	450,000
Materials used	334,000	
Direct labor	360,000	
Indirect labor	137,000	
Taxes and insurance	15,000	
Depreciation	27,000	
Power	22,000	
Maintenance	16,000	
Selling expense	178,000	
Doubtful accounts (provision)	35,000	
Administrative expense	60,000	
Discounts allowed	23,000	
Dividends paid	200,000	
Additional 1934 income tax	7,000	
6% interest on above from March 15, 1935	1,000	

Allowance for doubtful accounts		$ 125,000		$ 105,000
Allowance for branch losses		75,000		75,000
Allowance for depreciation		125,000		108,000
Accounts payable		452,000		664,000
Capital—Preferred		400,000		
—Common		750,000		500,000
Surplus		557,000		557,000
Sales		1,240,000		
Discounts earned		6,000		
Life insurance (death claim)		25,000		
Premium on preferred stock (June 30, 1937)		12,000		
Interest		5,000		
Totals	$3,772,000	$3,772,000	$2,009,000	$2,009,000

Home office inventories, December 31, 1936

Finished product	$132,000
In process	50,000

Branch-office Trial Balance
December 31, 1937

Cash	$ 42,000	
Inventory January, per audit (2,500 units)	75,000	
Administrative expense	24,000	
Selling expense	96,000	
General expense	5,000	
Purchases (10,000 units from home office)	350,000	
Interest (home office)	3,000	
Deficit	75,000	
Furniture and fixtures	80,000	
Home office		$250,000
Sales		480,000
Allowance for depreciation		20,000
Totals	$750,000	$750,000

There were 4,400 finished units on hand at the factory December 31, 1936, and 26,500 additional units were completed during the year. In-process inventories on December 31, 1937, amounted to $60,000.

The company manufactures electric cleaners which are sold at retail either directly by the factory (home office) or by its sales branches. All sales are at the uniform price of $50 per unit. Usually a 10 per cent cash payment is received at the

time of sale and subsequent instalments are payable at the rate of $3 a month. A selling commission of 20 per cent is paid when the cleaner is delivered.

A review of instalment accounts receivable indicates that only the following may be considered collectible at December 31, 1937.

1934	$20,000	1936	$210,000
1935	90,000	1937	790,000

By reason of the low-salvage value the company does not attempt to repossess cleaners from its defaulted accounts.

Operations of 1934, 1935 and 1936 have been audited. The gross profits were 30, 34 and 37 per cent of the selling price, respectively.

$400,000 par value of preferred stock sold on July 1, 1937, is redeemable June 30, 1957, at 105; $250,000 par value of common stock was sold at par.

THE OHIO STATE BOARD OF ACCOUNTANCY

COMMERCIAL LAW

Examination, May, 1938

1. (*a*) What is an assignment for benefit of creditors?
   (*b*) Explain difference between an assignee and receiver.
   (*c*) What creditors are considered preferred under Ohio statutes?
   (*d*) What is a mechanic's lien?
2. (*a*) Does partial payment of a joint and several note by one maker prevent running of the statute of limitations against the others?
   (*b*) When is a note legally due that specifies no time of payment but provides for interest payable semi-annually?
   (*c*) Does issuance of a note extinguish the debt for which it is given?
   (*d*) What effect has the discharge of a prior endorser of a note on the subsequent endorsers?
3. (*a*) An Ohio corporation has sufficient capital surplus and desires to eliminate its deficit. What procedure should follow?
   (*b*) Are cumulative dividends on preferred stock considered a liability of the corporation?
   (*c*) A corporation wishes to reduce its common stock from $10 par value per share to no-par value—what action is necessary?
   (*d*) Are preferred stock certificates endorsed in blank considered negotiable instruments?
4. (*a*) When does title pass on sale of goods?
   (*b*) What constitutes acceptance under a contract of sale?
   (*c*) What constitutes receipt under a contract of sale?
   (*d*) Where is the risk of loss after a contract of sale?
5. (*a*) Who are common carriers?
   (*b*) Name two things that distinguish "common" and "private" carriers.

(c) How can a common carrier escape liability for loss of goods?
(d) When does the liability of a common carrier end?

6. (a) Name three characteristics of negotiable instruments.
(b) Distinguish negotiation from assignment.
(c) When should a check be presented for payment?
(d) A bank erroneously dishonors a check—has the drawer any remedy?

7. (a) What is agency?
(b) What is a principal's liability for the acts of his agent?
(c) When is an agent alone liable?
(d) A stock-transfer agent fraudulently issues stock certificates that he sells for his own benefit—is the corporation liable?

8. (a) Name three classes of contracts.
(b) What is meant by a contract being entered into under duress?
(c) What effect has a mistake on the part of the parties?
(d) What is waiver?

9. (a) Name two classes of partnerships and explain their functions?
(b) What is the distinction between partners and co-owners?
(c) Can a partner's interest in firm property be reached to satisfy creditors of the individual partner?
(d) What is the extent of the individual partner's liability for the debts of the firm?

10. (a) What is the distinction between real and personal property?
(b) How is each taxed under Ohio laws?
(c) In determining taxable credits under the Ohio Intangible Tax Law indicate whether the following should be included:

Accrued real estate taxes	Investments in capital stock of other corporations
Accounts payable	Investments in corporation bonds
Notes receivable (30 day notes)	Instalment accounts receivable (due after one year)
Accounts receivable (current)	
Investments in land-trust certificates	

AMERICAN INSTITUTE OF ACCOUNTANTS

BOARD OF EXAMINERS

EXAMINATION IN AUDITING

May 12, 1938, 9 a.m. to 12:30 p.m.

The candidate must answer all questions.

No. 1 (8 points):

To what extent should original vouchers be examined and bookkeeping details checked in a balance-sheet examination? Give reasons for variations in program.

No. 2 (8 points):

How can reports under the Federal social security act be used as a safeguard against padded payrolls?

No. 3 (8 points):

For a number of years you have audited the books and accounts of a concern which has just been thrown into receivership. You are asked by the minority interests, who are instituting legal action for mismanagement, to audit the books and to assist them in these proceedings. State the conditions under which you would accept the engagement or why you would decline it.

No. 4 (8 points):

The capital of a corporation consists of 1,000 shares of cumulative preferred stock of $100 par value, and 2,000 shares of common stock of no-par value having a paid-in value of $200,000. The preferred stock is owned by the public, and the common stock by the president of the company except for a few qualifying shares held by other directors. The company was organized

at the beginning of the year and its operations resulted in a small loss.

The president, desirous of paying a dividend on the preferred stock, authorized the payment to himself of $7,000 as commission in addition to his salary and this amount he personally distributed as the year's dividend to the preferred shareholders.

How should you deal with this matter in your report, and how should the transaction be shown on the books and on the financial statements of the corporation?

No. 5 (8 points):

According to the law in a certain state, property taxes for 1938 are due on April 1, 1938. They are based on assessed values at April 1, 1937, and are intended to pay the expenses of government for the fiscal year ending June 30, 1938. In these circumstances, how would you treat a 1938 property tax of $12,000, due and payable on April 1, 1938, in the accounts of a corporation on March 31, 1938, the close of its fiscal year?

No. 6 (10 points):

You are engaged by a bank to prepare a certified balance-sheet of a partnership which is seeking a loan, and the following trial balance is submitted to you:

Assets		*Liabilities*	
Cash	$ 3,000	Notes payable	$300,000
Accounts receivable	75,000	Accounts payable	215,000
Inventory	492,000		
Deferred charges	15,000	Partner A capital a/c	230,000
Partner C capital a/c	260,000	Partner B capital a/c	100,000
Total	$845,000	Total	$845,000

Partner C had withdrawn considerable sums which were charged to his capital account. He is wealthy and gave the firm as security certain high-class bonds and stocks that have a market value of $500,000. The partners argue that in the circumstances C's indebtedness should be shown as an asset.

Assuming that you have verified the above accounts,

(a) Give your reasons for assent or non-assent to the partners' argument.

(b) Draft the balance-sheet you will certify.

No. 7 (10 points):

How would you verify the receipts from

(a) Subscriptions, donations and bequests to charity,
(b) Club dues and entrance fees,
(c) Church collections?

No. 8 (10 points):

When and how should transactions that have occurred at the time of your examination but since the close of the fiscal year be shown on the balance-sheet? Cite at least six specific instances of transactions that should be shown.

No. 9 (15 points):

(a) What accounts should be charged with (1) additions and betterments, (2) renewals and replacements, and (3) repairs and maintenance, when no detailed property records are kept, but adequate provision has always been made for depreciation at a composite rate applied to the year's opening balance of "building, machinery and equipment account" and credited to "depreciation reserve," and when the property account has always been credited with the net proceeds from sales of plant, machinery, and equipment?

(b) What simple safeguards can be applied in such a case to forestall the accumulation of reserves in excess of the respective property values?

(c) When is the method described under (a) admissible?

(d) How can it be modified to insure a higher degree of accuracy?

(e) What are its advantages and disadvantages?

No. 10 (15 points):

Describe the accounting procedure by which the management can determine to what extent

(a) Advantage is taken by the company of cash discount in the settlement of its liabilities.
(b) Customers have availed themselves of their discount privileges.

Also discuss the useful ends that will be attained by such a procedure.

AMERICAN INSTITUTE OF ACCOUNTANTS

BOARD OF EXAMINERS

EXAMINATION IN ACCOUNTING THEORY AND PRACTICE—PART I

May 12, 1938, 1:30 p.m. to 6:30 p.m.

Candidates are required to solve 3 problems, as follows: Problem No. 1, either problem No. 2 or No. 3, and problem No. 4.

No. 1 (15 points):

(a) The Acme Manufacturing Corporation uses a process-cost system; manufacturing costs, other than direct materials and direct labor, are applied to the product in an amount equal to 50% of the direct labor cost and, per contra, are credited to an account, "indirect costs absorbed." The books were closed as of December 31, 1937, when the inventory of goods in process in Process A consisted of 1,000 units of product as follows:

Direct material content (100% complete)	$5,000
Direct labor content (average 50% complete)	2,000
Indirect cost (at 50% of direct labor costs)	1,000
Total	$8,000

In January, 1938, 10,000 additional units of product were started; material requirements in full were issued at a cost of $51,000; direct labor amounted to $39,900; indirect cost was applied at 50% of the direct labor cost; 9,000 units were completed and transferred to the next process; 2,000 units remained in process on January 31st with material fully supplied and labor averaging 50% complete.

Set up a goods-in-process account for Process A showing total and unit material, labor and indirect costs for units completed and for units in process at end.

(b) The books were not closed on January 31st, and after the transfer of completed units was made it was discovered that

indirect costs in January, 1938, and in prior periods were actually 60% of direct labor cost.

Prepare the correcting journal entry.

No. 2 (25 points):

John Jones died September 30, 1936, leaving a will and appointing three executors to administer his estate. The will provided for the payment of funeral expenses, debts, and other necessary expenses, and for the following specific bequests:

Cemetery, for upkeep of burial plot	$ 2,500
Hospital	2,000
Church	5,000
Relative	10,000
Executors ($5,000 each in lieu of fees)	15,000
Total	$34,500

The balance of the estate was to be held in trust and the income thereof was to be paid in equal shares to the three children of the testator during their natural lives. The first distribution from income was to be made December 31, 1937. On the death of each of the life beneficiaries, the proportionate part of the estate as at that date was to revert to that beneficiary's issue surviving, if any; otherwise to remain in trust.

At date of death the testator was possessed of the following: cash, $25,000; accounts receivable, $55,000; 5½% first-mortgage bonds, interest June 30th and December 31st, par value and appraised value, $100,000; U. S. 2¾% Treasury bonds, interest May 15th and November 15th, par value and appraised value, $50,000; 1,000 shares A Mining Company stock, par value $5 per share, appraised as valueless; 1,000 shares B industries, Inc. stock, par value $100, appraised at $110; clothing, $1,000; jewelry, $5,000; furniture, $10,000.

Receipts:

November 15, 1936, $40,000 U. S. Treasury bonds sold at $102; accounts receivable collected, $50,000 (balance worthless); dividends on B industries, Inc. declared prior, but paid subsequent to death of testator, $4,000; dividend of same company declared and paid subsequent to death of testator, $2,000; furniture sold for $9,000; A Mining Company stock sold at

25 cents per share; bank interest earned after death, $1,250; refund of Federal taxes, year 1935, $500. All interest collected on investments.

Disbursements:

Funeral expenses, $2,500; administration expenses (chargeable to corpus), $8,000; legal services, $3,000; debts of testator, $15,000; 1936 Federal and state taxes to date of death, $3,100; all specific bequests paid, relative taking jewelry at appraised value against bequest of $10,000.

Other transactions:

Clothing given to charity.

Prepare as of November 30, 1937, (a) summary statement of executors as to principal, showing assets remaining in the estate; (b) summary statement of executors as to income.

NOTE 1.—For purposes of this problem ignore the factors of inheritance, transfer and other taxes not specified in problem.

NOTE 2.—Attach all working papers to your solution.

No. 3 (25 points):

The following appraisal was made of the plant and equipment of the Hopewell Company as at December 31, 1936:

Classification	Reproduction value—new	Accrued depreciation	Sound value	Depreciation rates
Land	$ 250,000		$250,000	
Buildings	530,000	$35,000	495,000	2%
Machinery—A	100,000	10,000	90,000	6%
" —B	80,000	10,000	70,000	8%
Special tools	30,000	6,000	24,000	10%
Furniture, etc	43,000	8,000	35,000	12½%
Trucks and autos	42,000	12,000	30,000	20%
Together	$1,075,000	$81,000	$994,000	

The appraisal was formally accepted by the company and the bookkeeper was instructed to make the necessary adjustments on the books as of the above date, at the same time setting up depreciation reserves. Thereafter depreciation was to be provided at the new rates by straightline methods but, as heretofore, on the year's additions and retirements at one half of the annual rates.

In the course of the audit of the 1937 accounts the auditor was given the following analysis of the property accounts, prepared by the bookkeeper:

Classification	Dec. 31, '36 Net balance before adjustment	Adjustment to appraisal Dr. Cr.*	1937 Additions or retirements* (gross)	1937 Depreciation	Balance Dec. 31, 1937
Land..........	$ 210,000	$ 40,000	$30,000*		$220,000
Buildings.........	520,000	25,000*	50,000	$10,400	534,600
Machinery.......	175,000	175,000*			
" —A ...		90,000	10,000	6,650	93,350
" —B....		70,000	20,000*	4,200	45,800
Miscell. equip.....	95,000	95,000*			
Special tools......		24,000	10,000*	2,850	11,150
Furniture, etc.....		35,000	15,000	6,375	43,625
Trucks and autos .		30,000	14,000*	3,450	12,550
Together......	$1,000,000	$ 6,000*	$ 1,000	$33,925	$961,075

All retirements had been deducted at appraised reproduction value.

Prepare columnar summary statements of (a) property and (b) reserve accounts, both showing the correct adjustment of the books to the appraisal and the rectification of the bookkeeper's errors. (c) State briefly the nature of the errors of principle in the bookkeeper's analysis.

No. 4 (60 points):

Four municipalities—Rose City, Copperville, Pineboro, and Coletown—formed the Spring Valley Water Commission for the construction and operation of a joint water supply. The project was estimated to cost $10,000,000 and to have a capacity of 100 million gallons daily (MGD).

It was agreed that the capital costs were to be apportioned among the participating municipalities according to the daily water allotments, but no municipality should be charged for the cost of any part of the project unless it were to receive benefit therefrom.

Capital assessment:

The four municipalities allotted the entire estimated supply of 100 MGD among themselves and agreed to an initial assessment

of the estimated cost of $10,000,000 in proportion to these allotments as follows:

	MGD	Assessment
Rose City	30	$ 3,000,000
Copperville	20	2,000,000
Pineboro	10	1,000,000
Coletown	40	4,000,000
Total	100	$10,000,000

All capital assessments were collected in full except that of Copperville which paid only 90% of its assessment.

Expenditure to Dec. 31, 1935:

At the close of 1935 Spider Dam and Crabtree Reservoir were completed and pipe lines had been laid, namely, twin pipe lines from Spider Dam to the point where Rose City takes off the water and a single pipe line below that point. The cost per mile of the twin pipe lines was twice the cost per mile of the single line, and it was assumed that the twin lines were constructed for the benefit of all the municipalities. For convenience the capital costs are identified by classes as follows:

Class A Cost of Spider Dam and other costs at the headworks.

Class B Twin pipe lines from Spider Dam and the headworks to the Rose City take-off—a distance of five miles.
(In accordance with the agreement the expenditures under A and B are to be distributed to all of the four participating municipalities on the basis of the contract allotments.)

Class C Single pipe line from Rose City take-off to Copperville take-off—a distance of three miles.
(This capital cost is accordingly apportionable to Copperville, Pineboro and Coletown.)

Class D Single pipe line from Copperville take-off to Pineboro take-off—a distance of two miles.
(This capital cost is apportionable to Pineboro and Coletown.)

Class E Single pipe line from Pineboro take-off to Coletown take-off—a distance of ten miles.
(This entire capital cost is chargeable to Coletown.)

The capital costs up to January 1, 1936, when operation began, were as follows:

Construction costs:	
Headworks:	
Spider Dam	$2,000,000
Pumping station	300,000
Power house	200,000
Total	$2,500,000
Aqueduct:	
$100,000 per mile of single pipe line.	

Land, rights of way, etc.:	
Class A	$1,993,100
Class B	447,800
Class C	198,900
Class D	104,200
Class E	256,000
Total	$3,000,000

Engineering costs:	
Direct charges to classes:	
Class A	$ 440,000
Class B	120,000
Class C	80,000
Class D	60,000
Class E	100,000
Total	$ 800,000

Indirect charges—$200,000 (to be apportioned to classes in proportion to direct engineering costs).

Administrative expenses—$500,000 (to be apportioned to classes in proportion to all construction costs up to January 1, 1936, exclusive of land and engineering costs).

Operating assessment 1936:

It was further agreed that the operating costs were to be apportioned according to actual water consumption, but in no event was the basis for any municipality's portion to be less than the contract allotment. The surplus or deficit resulting from each year's operations was to be credited or charged to the succeeding year's operating assessments.

In 1936 the average daily consumption was:

Rose City	40 MGD
Copperville	10 "
Pineboro	5 "
Coletown	25 "
Total	80 MGD

The 1936 operating expenses, estimated at $100,000, had been assessed as follows:

Rose City	$ 30,000
Copperville	20,000
Pineboro	10,000
Coletown	40,000
Total	$100,000

Rose City was the only municipality that paid its operating assessment in 1936.

Expenditure 1936:

The actual expenditures for 1936 were as follows:

Capital:

It was necessary to build a surge tank to prevent water surges from breaking the aqueduct. The tank cost $100,000 and was constructed halfway between the Rose City and Copperville take-off points. It was agreed that this surge tank was of benefit to all the participating municipalities.

Operating:

$71,000

In addition to the capital and operating expenses listed above, 1936 engineering expenses were $16,000, to be apportioned 50% to the capital division and 50% to the operating division; and 1936 administrative expenses were $25,000, to be apportioned 80% to the operating division and 20% to the capital division. The portions of the engineering and administrative expenses chargeable to the capital division are to be applied to the several classes of property on the basis of the engineering and the construction costs respectively to January 1, 1936.

Water sales 1936:

The Spring Valley Water Commission, in anticipation of the underconsumption of water on the part of some of the participating municipalities, entered into a contract with Glendale for

1936 whereby this municipality agreed to pay $30 a million gallons for water. The contract provided that Glendale would take a minimum of ten million gallons a day. Glendale paid the Commission $7,500 a month on account; its consumption for the year was 3,300 million gallons. There were no expenses chargeable to the water-sales division except $30,000 representing the cost of connecting the pipe lines, which is not included in the above $71,000 operating expenses.

Profits from the sale of water to municipalities not participating in the project were to be apportioned annually to the participating municipalities on the basis of operating expenses charged to them.

General data and requirements:

The accounts of the commission are kept in three self-balancing divisions, namely: "capital," "operating," and "water-sales." At the end of 1936 all interdivisional balances are settled in cash to the extent that funds are available in the divisions.

Prepare a balance-sheet (with supporting schedules and work papers), separately showing assets and liabilities of each division as of December 31, 1936, including the balances due from and due to the respective municipalities, and the equities of the participating municipalities.

AMERICAN INSTITUTE OF ACCOUNTANTS

BOARD OF EXAMINERS

EXAMINATION IN COMMERCIAL LAW

May 13, 1938, 9 a.m. to 12:30 p.m.

Reasons must be stated for each answer. Whenever practicable give the answer first and then state reasons. Answers will be graded according to the applicant's evident knowledge of the legal principles involved in the question, rather than on his conclusions.

Group I

Answer all questions in this group

No. 1 (10 points):

In transactions covered by the statute of frauds, other than sales at public auction, what should the note or memorandum specify and by whom and how should it be signed?

No. 2 (10 points):

Jones, in writing, guaranteed payment for merchandise to be sold by White to Baker, and after such sales had been made Baker gave to White a non-negotiable note, payable on demand, for the amount agreed to be due. Jones had no knowledge of the giving of this note until Jones, as surety, was sued by White upon Baker's failure to pay. Was Jones released from liability by White's accepting this note?

No. 3 (10 points):

Plaintiff, the owner and in possession of certain merchandise, requested defendant to procure a purchaser, but made no agreement with defendant as to compensation. Defendant procured a purchaser, collected the sales price specified by plaintiff, and

sent to plaintiff a check for the proceeds less 10% commission. Plaintiff cashed the check but protested at once that the deduction was unauthorized and now sues to recover it. Was plaintiff's acceptance of this check an accord and satisfaction?

No. 4 (10 points):

(a) Define a check drawn on a bank.

(b) Within what time should a check be presented for payment, and what is the legal effect upon any of the parties thereto of a failure to present it within that time?

(c) What is the legal effect of the certification of a check by the bank on which it is drawn?

(d) If the holder of a check procures its certification, how are the other parties thereto affected?

No. 5 (10 points):

Discuss the legal effect of offers, counter-offers, and rejections of offers in the formation of a contract. Illustrate by a simple example what is meant by a meeting of the minds.

Group II

Answer any five questions in this group. No credit will be given for additional answers, and if more are submitted only the first five will be considered.

No. 6 (10 points):

On October 1, 1937, a corporation which had issued only no-par value stock had 2,316 shares outstanding. This outstanding capital stock was carried at $50,000 and the corporation's surplus was $100,000. On that day the board of directors legally adopted a resolution directing the transfer of $90,000 from the surplus account to the no-par-value capital-stock account. Did this transaction constitute the declaration of a dividend?

No. 7 (10 points):

(a) Define and describe conditional sales.

(b) How can the seller usually protect himself in such sales?

(c) Upon default by the buyer in a conditional sale, what are the seller's usual rights as to retaking possession of the goods sold?

(d) After such a seller has lawfully retaken possession, what are the buyer's usual rights as to redemption?

No. 8 (10 points):

Under the by-laws of a corporation, the term of office of president was one year. Defendants and plaintiff together owned a majority of the voting stock and constituted a majority of the board of directors. They made a written contract, with consideration, which provided that plaintiff was to be annually elected president during a period of three years. Upon what ground, if any, could this contract be held invalid?

No. 9 (10 points):

On a Saturday afternoon X signed a check for $7,000 and gave it to the payee as a gift. On the next day X was killed in an accident. On the following Monday morning, the payee cashed the check at the bank on which it was drawn, said bank having neither actual nor constructive notice of X's death.

(a) Can X's estate recover from the bank the amount of this check?

(b) Can X's estate recover the amount of it from the payee?

No. 10 (10 points):

(a) How in general does a corporation qualify to conduct business in a state other than the state of its incorporation?

(b) What risks does it incur if it conducts business without formally qualifying?

(c) What factors would you, as an accountant, take into consideration in rendering an opinion as to the desirability of a corporation's qualifying in a certain state?

No. 11 (10 points):

With reference to the surtax on the undistributed profits of a corporation subject to that surtax (other than a holding company affiliate or a national mortgage association) for the calendar year 1937, describe briefly and illustrate by a simple example each of the following items:

(a) adjusted net income,

(b) undistributed net income.

No. 12 (10 points):

The law of a state requires every domestic corporation doing only intrastate business to pay an annual tax computed by whichever of the following methods will yield the state the greater amount of revenue:

(1) 6% on its entire net income;

(2) 6% on a base obtained as follows: 30% of (entire net income + compensation paid to officers and to holders of more than 5% of its outstanding stock)—($5,000 + net loss).

(a) What was the purpose of requiring the use of base (2)?

(b) Compute the tax on the following facts:

Net profit on operations	$150,000
Financing expenses	15,000
Dividends paid to stockholders	40,000
Dividends received on stocks owned	17,000
Salaries and bonuses to officers	330,000
Compensation to employees owning more than 5% of outstanding stock	30,000

AMERICAN INSTITUTE OF ACCOUNTANTS

BOARD OF EXAMINERS

EXAMINATION IN ACCOUNTING THEORY AND PRACTICE—PART II

May 13, 1938, 1:30 p.m. to 6:30 p.m.

Candidates are required to solve 4 problems, as follows: Problem No. 1, either problem No. 2 or No. 3, either problem No. 4 or No. 5, and problem No. 6.

No. 1 (20 points):

On January 3, 1936, the Eastern Manufacturing Corporation organized a subsidiary, the Eastern Sales Company of France, to operate at retail in Paris. Not having had any previous experience with foreign exchange, the treasurer of Eastern Manufacturing Corporation consults you in February, 1937, concerning the valuation to be placed on the inventory of Eastern Sales Company of France at December 31, 1936, and the handling of intercompany transactions. The following data are furnished:

Sales of product by Eastern Manufacturing Corporation to Eastern Sales Company of France at $5 per unit, payable in dollars:

Feb. 15, 1936	200,000 units
Apr. 4, 1936	10,000 units
Jul. 20, 1936	20,000 units
Nov. 16, 1936	50,000 units

Freight and duty paid by Eastern Sales Company of France on such purchases amounted to 10 francs per unit.

The cost to Eastern Manufacturing Corporation of the product manufactured by it is $4 per unit.

The wholesale replacement value (f.o.b. Paris) of a more or less similar article of French manufacture was 110 francs per unit during the months of December, 1936, and January, 1937.

Remittances made by Eastern Sales Company of France to Eastern Manufacturing Corporation were:

Oct. 1, 1936	4,000,000 francs
Dec. 11, 1936	5,000,000 francs

The published exchange rates per franc were as follows:

Jan. 3, 1936	$.0660
Feb. 15, 1936	.0668
Apr. 4, 1936	.0659
Jul. 20, 1936	.0662
Oct. 1, 1936	.0487
Nov. 16, 1936	.0465
Dec. 11, 1936	.0466
Dec. 31, 1936	.0467

The following information is requested:

1. A statement showing the transactions in the intercompany dollar account with Eastern Manufacturing Corporation as they should be recorded in the books of Eastern Sales Company of France.
2. The value at which 100,000 units on hand at December 31, 1936, should be carried on the balance-sheet of Eastern Sales Company of France. This balance-sheet is to be made up in francs and in dollars and the inventory must therefore be valued in both currencies.
3. The amount of intercompany profit which should be eliminated from inventories at December 31, 1936, upon the consolidation of the balance-sheets of the two companies.

No. 2 (20 points):

You are engaged by the Xenia Manufacturing Company to examine its books, which have never been audited before by public accountants. The following unaudited statements are presented to you:

BALANCE-SHEET—DECEMBER 31, 1937

Assets

Cash	$ 160,000
Investments	300,000
Accounts receivable	200,000
Inventories	800,000
Prepaid insurance	20,000
Property	5,000,000
Treasury stock	1,000,000
Total	$7,480,000

Liabilities

6% notes payable	$ 300,000
Accounts payable	50,000
Accrued expenses	70,000
Reserve for doubtful accounts	70,000
Reserve for depreciation	1,600,000
Reserve for Federal income taxes	26,000
Capital stock—$100 par value	5,000,000
Surplus	364,000
Total	$7,480,000

PROFIT-AND-LOSS STATEMENT
For the year ended December 31, 1937

Net sales	$3,500,000
Cost of sales	2,430,000
Gross profit on sales	$1,070,000
Selling and administrative expenses	900,000
Balance	$ 170,000
Other income	20,800
Total	$ 190,800
Interest on notes payable	19,500
Balance	$ 171,300
Provision for Federal income tax	26,000
Net profit	$ 145,300

As a result of your examination the following information has become available.

In order to record as many transactions as possible which were applicable to 1937, the company kept open the cash-receipts book, the check register, and the voucher register until the middle of January. As a result checks for $200,000, received in January in payment of customers' November and December accounts, were included in the receipts book; checks for $150,000, issued in January in payment of vendors' December invoices, were entered in the check register; and $80,000 vendors' invoices, received in January for goods and services delivered in December, were recorded in the voucher register. Of the latter amount $50,000 represented goods included in the closing inventories and $30,000 was for expense items.

The investments consist of:

Premiums paid for insurance policies on the lives of officers—$80,000. The policies were written for $400,000. They

had a cash surrender value at December 31, 1937, of $50,000 and a cash surrender value at December 31, 1936, of $40,000. The premiums paid during the year amounted to $15,000.

Cost of 2,600 shares of capital stock of Xenia Manufacturing Company—$220,000. This stock was purchased in 1932 because the price was considered cheap. The company now intends to retire these shares.

A discussion of the accounts receivable reveals that $50,000 are uncollectible. However,, the officials convince you that the reserve for doubtful accounts is sufficient to provide for this loss and, in addition, for any further losses which might be incurred in the liquidation of the accounts outstanding.

The inventories consist of:

Raw materials and supplies	$200,000
Finished product	600,000

Raw materials and supplies are carried at cost, which is below current replacement value. For simplicity the company carries its finished-product inventory at 50% of the selling price. Former inventories have always been carried at cost, and upon your advice it has been decided to continue this practice. The officials point out and you have verified that the gross-profit margin on products is uniform and has remained the same for the past two years.

An analysis of the property account shows the following composition which represents cost.

Land	$ 200,000
Buildings	800,000
Machinery and equipment	3,000,000
Patents	1,000,000
Total	$5,000,000

The treasury stock represents 10,000 shares authorized by the corporation's charter but not yet issued.

The notes payable are secured by a mortgage given in connection with the purchase of land and buildings. The notes become due at the rate of $50,000 each July 1st.

The reserve for depreciation has been analyzed for the year as follows:

	Buildings	Machinery and equipment	Patents
Balance, December 31, 1936	$150,000	$ 930,000	$355,000
Provision for the year 1937	20,000	150,000	75,000
Total	$170,000	$1,080,000	$430,000
Less: Reserve accrued on patents sold			80,000
Balance, December 31, 1937	$170,000	$1,080,000	$350,000

The reserve for Federal income taxes is estimated as 15% of the net profit of $171,300, rounded upward to the nearest thousand dollars. Your scrutiny of returns for prior years indicated no important adjustments to book profits, and you are satisfied that there will be no substantial additional assessments.

The surplus account has been summarized as follows:

	Dr.	*Cr.*
Premium of $5 per share on sale of 40,000 shares of capital stock		$ 200,000
Transfers from profit-and-loss account to December 31, 1936		1,938,700
Transfers from dividend-paid account to December 31, 1936	$1,600,000	
Transfer from profit-and-loss account for 1937		45,300
Transfer from dividend-paid account for 1937 (being dividends at $8 per share)	$ 320,000	
Totals	$1,920,000	$2,284,000
Balance, December 31, 1927		$ 364,000

Net sales include $300,000 proceeds from the sale of patents which have not been used to any great extent by the company. They cost $250,000 which amount, less the reserve of $80,000 accrued there-against, is included in cost of sales.

Prepare the financial statements for inclusion in the annual report to stockholders.

No. 3 (20 points):

The American Investment Trust, a Delaware corporation, was organized June 30, 1929 with an authorized capital of 10,000

shares of no-par-value stock, all of which was sold at $110 a share. The directors assigned a value of $100 a share to the capital stock.

The annual reports to the stockholders for the calendar years 1932, 1933, and 1934 were prepared by the company's bookkeeper and included the following statements of surplus:

SURPLUS ACCOUNT, 1932

Earned surplus, January 1, 1932		$250,000
Deduct: Net loss for 1932		200,000
Balance		$ 50,000
Capital surplus, January 1, 1932, representing excess of amount realized over assigned value of capital stock	$100,000	
Add: Surplus resulting from reduction of assigned value of capital stock to $50 a share	500,000	600,000
Total		$650,000
Deduct: Write-down of the cost of investments to market prices at December 31, 1932		579,000
Surplus, December 31, 1932		$ 71,000

SURPLUS ACCOUNT, 1933

Balance, January 1, 1933	$ 71,000
Add:	
Excess of assigned value over cost of 1,000 shares of capital stock retired	10,000
Net income for 1933	40,000
Surplus, December 31, 1933	$121,000

SURPLUS ACCOUNT, 1934

Earned surplus, January 1, 1934, representing net income for 1933		$ 40,000
Add: Net income for 1934:		
Six months ended June 30	$40,000	
Six months ended December 31	35,000	75,000
Total		$115,000
Deduct: Dividend paid December 31, 1934, $6 a share		48,000
Balance		$ 67,000
Capital surplus, after deducting $5,000 representing the net excess of cost over assigned value of 2,000 shares of capital stock retired		66,000
Surplus, December 31, 1934		$133,000

The balance-sheet at December 31, 1934, as prepared by the bookkeeper, was as follows:

Assets

Cash in bank		$ 38,000
Marketable securities (as per books)		493,550
Prepaid expenses		750
Treasury stock, 500 shares at cost		7,500
Total assets		$539,800

Liabilities

Management fee		$ 2,600
Taxes payable, including Federal income taxes		4,200
Total liabilities		$ 6,800

Net Worth

Capital stock, 8,000 shares	$400,000	
Surplus	133,000	533,000
Total liabilities and net worth		$539,800

As a result of your audit of the company's accounts you ascertain further: (a) that no investment securities had been purchased or sold since December 31, 1932; (b) that on December 31, 1932, the stockholders approved (1) the reduction of the assigned value of the company's capital stock to $50 a share, (2) the write-down of the marketable investments to market quotations, and (3) the transfer of any deficit to capital surplus; (c) that the securities at December 31, 1934, market prices amounted to $723,400; (d) that the treasury stock represents the 500 shares acquired at low cost June 30, 1934, namely, for $7,500; (e) that 1,000 of the company's shares were acquired in 1934 and were retired September 30, 1934; and (f) that the authorized capital stock had been legally reduced by the 2,000 shares retired.

Prepare (1) a columnar statement of the annual surplus accounts in which capital and earned surplus are set forth in separate columns with a column for the total surplus; and (2) a balance-sheet at December 31, 1934, which you would be willing to certify.

No. 4 (20 points):

The Green Valley Cattle Company is a corporation operating a large ranch. It has been in business a number of years and has built up a large surplus, all of which has been kept in the business either in livestock or land investments.

At the beginning of the year 1937 there were on the books the following accounts: inventory of stock cattle, $186,000; inventory

of steers, $69,000; inventory of calves and yearlings, $43,500; land, $250,000; buildings, $60,500; farm machinery and equipment, $18,000; farm work animals, $15,000; saddle horses, $7,000; cash in bank, $16,800; accounts payable, $6,200; notes payable, $3,000; bonds payable, $50,000 (interest payable semi-annually, July 1st and January 1st); capital stock, $50,000; and surplus.

During the year all liabilities were paid except the bonds, and additional expenditures were made for labor, $14,000; feed, $30,000; seed, $4,000; insurance, $2,500; taxes, $11,500; freight, $3,500; purchases of steers, $32,000, of land, $12,500; equipment for farm, $2,500; and bond interest coupons, $3,000. Receipts were for sales of steers, $68,500; sales of yearlings and calves, $32,000; sales of stock cattle, $16,500; sales of junk machinery, $100; sale of mineral rights on 5-year contract, $25,000. The inventories at the end of the period were: stock cattle, $165,000, yearlings and calves, $45,000, and steers $71,000.

All products from the farm were being used to feed the cattle. There were no unpaid bills at the end of the year, and the feed inventory need not be considered. There were losses by deaths during the year as follows: saddle horses, $350; stock cattle, $1,800; steers, $1,650; and yearlings and calves, $900.

No depreciation had ever been taken in the past and in the solution of this problem it may be disregarded. It will be unnecessary to consider Federal or any other taxes.

Immediately following the end of the year 1937, and before any business had been done in 1938, except the declaration and payment of a cash dividend of $30,000, the cattle and the title to the land and all other farm properties were sold for a flat sum of $600,000 cash and the assumption by the buyer of the bonded liability and of the obligations under the mineral-rights contract.

Prepare a columnar work sheet showing the trial balances at the beginning and the end of the year, as well as the subsequent sale of the property.

No. 5 (20 points):

The following is a trial balance of the Allegheny Manufacturing Company as at December 31, 1937, before closing:

	Dr.	*Cr.*
Cash	$ 50,000	
Accounts receivable	150,000	
Reserve for discounts		$ 9,000
Inventory raw materials 1-1-37	100,000	
Inventory work in process 1-1-37	9,700	
Inventory finished product 1-1-37	22,000	
Machinery and fixtures	60,000	
Reserve for depreciation		15,000
Prepaid expenses	2,000	
Accounts payable		30,000
Capital stock		200,000
Undivided profits		176,200
Sales		552,000
Discounts and allowances on sales	35,000	
Purchases raw material	194,400	
Labor	113,950	
Manufacturing expenses	151,950	
Depreciation	3,000	
Selling expenses	48,000	
General expenses	42,200	
Totals	$982,200	$982,200

The company manufactures a specialty product from a variety of raw materials. Three different kinds—A, B, and C—are produced, and based on previous experience, the cost is estimated to be:

	A	B	C	Average
Material	$10	$ 8	$ 6	$ 8
Labor	6	6	6	6
Overhead	6	6	6	6
Totals	$22	$20	$18	$20

The company used the average cost of $20 in valuing the opening inventory and fixed the sales price for the year at $30 per unit.

No record is available of the quantities put in process or produced of each product, but the $552,000 sales were found to be made up as follows:

Grade A	10,400 units	
Grade B	3,900 units	
Grade C	4,100 units	
Total	18,400 units at $30	$552,000

The opening inventory of work in process was comprised of: 700 units (mixed grades) with material cost, $5,600; labor cost, $3,050; and overhead expenses, $1,050—together $9,700.

The opening inventory of finished goods consisted of 1,100 units (mixed grades) at the average cost of $20 each or $22,000.

The inventory of work in process at the end of the year is 1,000 units (600 of A, 300 of B, and 100 of C). Each is completed to the extent of one-half cost as to labor and overhead expense, but contains all of the material cost.

The inventory of the finished product at the end of the year is 1,700 units (200 of A, 500 of B, and 1,000 of C).

The inventory of raw material at the end of the year is $80,000.

From the foregoing data:

1. Determine the cost of the finished goods and of the work in process at the end of the year and show fully how these costs were computed.
2. Prepare the annual accounts.

Also show the defects of cost system and budgeting methods.

No. 6 (40 points):

From the following information prepare a work sheet showing the consolidation of the balance-sheets of Top Company and its subsidiaries as at June 30, 1937:

Balance-sheets—June 30, 1937

Assets	Top Company	Black Company	White Company	Red Company
Cash	$ 10,000	$ 80,000	$ 60,000	$ 25,000
Accounts receivable		100,000	200,000	80,000
Inventories		200,000	300,000	100,000
Fixed assets	1,000	900,000	1,000,000	500,000
Prepaid expenses	500	5,000	6,000	3,000
Investments:				
Black Co.—$300,000 bonds	275,000			
Black Co.— 10,000 shares	300,000			
White Co.— 6,000 shares	690,000			
Red Co.— 800 shares	80,000			
Intercompany accounts	300,000	12,000	15,000	
Totals	$1,656,500	$1,297,000	$1,581,000	$708,000
Liabilities and Capital				
Accounts payable	$ 10,000	$ 95,000	$ 94,000	$150,000
Accrued taxes	5,000	10,000	18,000	4,000
Accrued interest		6,750		
Intercompany accounts		10,000		310,000
Notes payable to Top Company			200,000	
Reserve for depreciation	500	400,000	350,000	250,000
6% mortgage bonds, due October 1, 1946		450,000		
Capital stock—$100 par	1,500,000		800,000	100,000
Capital stock—10,000 shares, no par		300,000		
Earned surplus (deficit*)	141,000	25,250	119,000	106,000*
Totals	$1,656,500	$1,297,000	$1,581,000	$708,000

An analysis of Top Company's investment in subsidiaries shows the following:

	Date of transaction	Shares or bonds acquired or sold*	Cost or proceeds*	Surplus or deficit* of subsidiary at date of transaction
Black Company bonds	Sept. 30, 1932	$ 80,000	$ 76,000	$ 25,000
(bought for the	Nov. 30, 1934	$200,000	180,000	15,000*
sinking fund)	Dec. 29, 1936	$ 20,000	19,000	12,000
Black Company stock	Jul. 1, 1928	10,000 shs.	300,000	
White Company bonds	Jul. 1, 1932	$ 50,000	40,000	10,000*
	Oct. 1, 1935	$ 50,000*	50,000* (Redeemed)	
White Company stock	Jul. 1, 1929	8,000 shs.	1,000,000	100,000
	Dec. 1, 1936	2,000 shs.*	300,000* (Sold)	100,000
Red Company stock	Sept. 1, 1928	600 shs.	70,000	20,000
	Sept. 1, 1932	200 shs.	10,000	5,000*

The Top Company was incorporated in 1926. In the same year it incorporated a wholly owned subsidiary, the Green Company, with paid-in capital of $300,000. On July 1, 1928, the net assets of Green Company in the amount of $250,000 were transferred to Black Company in exchange for its capital stock, which has a stated value of $300,000. The difference between this stated value and the net assets taken over was added to the fixed assets of Black Company as representing goodwill. This goodwill amount has been amortized by Black Company by charges to operations at the rate of 5% per annum. Green Company was dissolved, the stock of Black Company being turned over to Top Company as a liquidating dividend.

There has been no change in the share capital of the subsidiaries since their incorporation.

On June 29, 1937, White Company drew a check to the order of Top Company for $2,000. This check was received and recorded by Top Company on July 1, 1937.

On June 3, 1937, Black Company shipped White Company merchandise in the amount of $5,000. White Company's accounting department did not receive the invoice for these goods and did not record the liability therefor. However, on taking the physical inventory at June 30, 1937, this merchandise was included at the value of $5,000.

At June 30, 1934, Black Company sold Red Company certain machinery for $80,000. Red Company has provided depreciation on this amount for the years ended June 30, 1935, 1936, and 1937,

at 10% per annum on the basis of an estimated useful life of ten years after the date of purchase. This machinery had cost Black Company $75,000, and that company had provided a depreciation reserve of $25,000 to June 30, 1934, on the basis of 6⅔% per annum. Black Company took the $30,000 book profit and eliminated from its accounts the cost of the machinery, as well as the accrued depreciation.

Inventories at June 30, 1937, included the following amounts purchased from affiliated companies:

Company	*Purchased from*	*June 30, 1937*
Red Company	White Company	$25,300
Red Company	Black Company	16,500
White Company	Black Company	86,000

White Company sold its products to affiliated companies at 15% and Black Company at 25% above cost.

At June 30, 1937, Top Company had discounted at the bank $200,000 notes receivable from White Company.

The Top Company has guaranteed the liabilities of the Red Company.

THE OHIO STATE BOARD OF ACCOUNTANCY

THEORY

Examination, November, 1938

1. An appraisal of a company's plant assets resulted in an increase of $300,000 over book values which represented cost at date of acquisition. You are called upon to advise the officials of the company on the merits and demerits of adjusting the books to the appraised values and also whether such an adjustment would affect future operating statements of the company. Explain.

2. (*a*) A corporation is contemplating the adoption of a pension plan under which payments are to be made to employees during their lifetime after they have rendered a certain number of years' service and become eligible for retirement. You are asked to prescribe the proper adjustment method.

   (*b*) What classification would you recommend these expenditures be given on the profit-and-loss statement? Should they be included as a factor in determining costs?

3. (*a*) To what extent does the earned surplus of a subsidiary company created prior to acquisition of its stock form a part of the consolidated earned surplus of the parent company and subsidiaries?

   (*b*) What portion of the earned surplus of the subsidiary is available for the payment of dividends to shareholders of the parent company?

4. How should reacquired shares be carried in the balance-sheet of a corporation—par value? Without par value?

5. (*a*) Under what circumstances do you believe good accounting practice permits a corporation to carry a reserve for selling and advertising expenses with the explanation that this account represents the difference between actual expenditures and budgetary allowance for such expenses?

(*b*) Under what circumstances do you believe it proper to defer such expenses?

6. (*a*) What basis of valuation should be used by a corporation in issuing par value stock to certain of its officers as a bonus?
(*b*) What basis of valuation for no-par stock?
(*c*) What treatment would you accord the income statement where shares are sold to officers or employees for services rendered at a cash price below market quotation?
(*d*) Would the same basis be used as a deduction for federal income taxes?

7. (*a*) What accounts would you prescribe for a corporation to set up a cash sinking fund of 5 per cent of annual net earnings to retire outstanding bonds in the subsequent year?
(*b*) What classification on the balance-sheet would you give the accounts?
(*c*) Do you consider it proper upon refunding a bond issue to carry forward as a deferred item any portion of the unamortized discount, expense and premium paid on bonds refunded over the life or a portion thereof of the new refunding bond issue?

8. (*a*) What is the proper treatment in an operating statement of royalties paid for use of patent rights?
(*b*) Of expenses incurred in procuring or developing a patent?

9. A corporation has an authorized first-mortgage 5 per cent bond issue of $2,000,000 and issues $1,000,000 of such bonds to a bank as security for bank loans of $500,000. How should this item be stated on the balance-sheet?

10. During the course of an audit you found that the factory cost of finished-goods inventory at the beginning of the year was 70 per cent of selling price and that during the previous five years this cost had varied between 60 and 70 per cent. Owing to decrease in selling prices, increased labor costs, social security taxes and lower production due to shutdown on account of labor difficulties the ratio at the end of the year was 105 per cent. What recommendation would you make to your client in evaluating the inventory at the balance-sheet date?

THE OHIO STATE BOARD OF ACCOUNTANCY

AUDITING

Examination, November, 1938

1. Discuss briefly the following:
   (*a*) The advantages of an audit.
   (*b*) The auditor's general duties.
   (*c*) Arrangements and schedules or statements required by auditor when audit is started.
2. How would you verify the following:
   (*a*) Cash on deposit.
   (*b*) Payment of notes payable.
   (*c*) The credits to accounts receivable other than cash receipts.
3. (*a*) How should inventories be valued?
   (*b*) Are inventories in every audit valued in the same manner? Give reasons.
   (*c*) To what extent should an auditor verify the inventory?
4. (*a*) Why should an auditor analyze the additions to permanent asset accounts?
   (*b*) How can an auditor approve additions to plant accounts?
   (*c*) Are all capital assets depreciable? Discuss.
5. (*a*) What is self-insurance?
   (*b*) How is it recorded on the books? Name the accounts and the entries to record.
6. (*a*) In the course of an audit you find that dividends have been charged to capital surplus. What comment will you include in your audit report?
   (*b*) Your audit discloses that earned surplus and capital surplus are combined into one account. What comment will you include in your audit report?
7. Audit-program items. Discuss the following questions:
   (*a*) Should adverse judgments and pending suits be included in an audit report?

(*b*) How can an auditor ascertain their existence?
(*c*) How are endorsements and other contingent liabilities verified?

8. (*a*) Discuss the purpose of making a comparison of balance-sheets at the beginning and the end of a period under review.
(*b*) State the purpose of balance-sheet ratios.

9. Outline your opinion of what an audit-report letter should contain. Use parts of paragraphs to outline the general make-up, and conclude with your certificate as auditor.

10. Your bill for services as a public accountant has been accepted in amount, but the client offers you stock in the company audited in place of cash. Discuss the effect of acceptance upon (*a*) the books of account of the client with reference to entry recording, (*b*) auditors' ethics and (*c*) future audits.

THE OHIO STATE BOARD OF ACCOUNTANCY

PRACTICAL ACCOUNTING

Examination, November, 1938

The Clothing Manufacturing Company sold 40,000 garments during 1937 at $20 per garment. Net profit (before federal taxes) for the year was 5 per cent of sales. Selling and administrative expenses amounted to 15 per cent of sales.

Material purchases were all put into production in Department 1. Each garment manufactured required 2½ yards of material. All material passed through each department in numerical sequence.

The cost of each finished unit (garment) consisted of material 50 per cent, labor 30 per cent, overhead 20 per cent. The cost experience of the company was identical in the preceding year.

	Inventory, January 1, 1937		Departmental proration of direct labor and overhead in finished product	Inventory, December 31, 1937	
	Quantity	Percentage of completion in department		Quantity	Percentage of completion in department
Dept. 1	5,000 yd.	25	10%	7,000 yd.	75
Dept. 2	2,000 yd.	100	10%	2,500 yd.	100
Dept. 3	2,000 units	50	40%	1,000 units	25
Dept. 4	3,000 units	80	40%	3,000 units	90

Effective January 1, 1938, there was an increase in material costs of 5 per cent and an increase in labor costs of 10 per cent.

Prepare a profit-and-loss statement for the year 1937 (disregarding federal taxes) and a statement of departmental operations.

THE OHIO STATE BOARD OF ACCOUNTANCY

PRACTICAL ACCOUNTING

Examination, November, 1938

The X Corporation completed refinancing in July, 1938, by the sale of a bond issue and additional common stock. For the purpose of this refinancing a forecast of operations for the calendar year 1938 was made and with these projection figures and information obtained from the books you are asked to prepare the following:

Balance-sheet after adjustments as at June 30, 1938.
Forecast of operations for the six months to end December 31, 1938.
Statement of estimated cash receipts and disbursements for the six months to end December 31, 1938, giving effect to the receipt of proceeds of refinancing and forecast for the remainder of the year.
Proforma balance-sheet as at December 31, 1938, after giving effect to forecast and refinancing.

	Forecast calendar year 1938	Actual six months to June 30, 1938	Cash transactions six months to June, 30, 1938	
			Disbursements	Receipts
Sales	$2,350,000	$850,000		$800,000
Cost of sales				
Raw materials	900,000	300,000	$350,000	
Direct labor	360,000	135,000	115,000	
Indirect labor	165,000	55,000	50,000	
Maintenance and repairs	37,000	15,000	12,000	
Engineering	120,000	50,000	45,000	
Erection	70,000	24,000	20,000	
Fuel and supplies	80,000	31,000	30,000	
Power	20,000	7,000	7,000	
Property taxes	5,000	2,500	2,500	
Other factory burden	55,000	19,000	17,000	

Shipping	$ 30,000	$ 10,000	$ 9,000	
Selling	300,000	155,000	140,000	
Administrative	55,000	30,000	25,000	
Other deductions	50,000	20,000	2,700	
Other income	5,000	2,500		$ 500
Plant and equipment			10,000	

Transactions and adjustments to be made:

Cash. Other deductions include payment of all interest due in the six months ended June 30, 1938.

Accounts receivable. Provide 0.5 per cent of sales for doubtful accounts and set up a reserve.

Inventories. Actual inventories at June 30, 1938, were $200,000.

Property, plant, and equipment. Additions during six months ended June 30, 1938, were $20,000. These additions consisted of new machinery installed during the month of May, 1938. There were no items scrapped or sold during the period. Depreciation rates are applied upon a blanket rate of 5 per cent. Depreciation is included in other deductions along with discounts allowed of $1,000 and interest expense.

Investments. Represents miscellaneous securities earning $1,000 per year. Balance of other income represents discounts earned.

Deferred. Changes as of June 30, 1938, expenses already included in actual results on books were as follows:

Other factory burden. Unexpired insurance increased $1,000.

Selling. Prepaid advertising increased $3,000.

Notes payable. On August 1, 1938, notes payable and mortgage payable were paid from proceeds of the sale of bonds, $190,000 net, and from the sale of common stock, 2,000 shares at $10 per share less 15 per cent selling commission and expense. The bonds were $200,000 first mortgage 5 per cent, due in 10 years, dated August 1, 1938, interest payable semi-annually.

Accruals. Includes as of January 1, 1938, accrued interest ($1,150), direct labor ($10,000), indirect labor ($5,000) and accrued taxes ($2,500). Amounts as of June 30 are unchanged except as determined from figures given in

schedule on page 663, i.e., direct and indirect labor, and salaries and wages (shipping $500, selling $5,000 and administrative $3,000).

Balance-sheet January 1, 1938

Cash	$ 50,000
Accounts receivable	190,000
Inventories	150,000
Property, plant and equipment	652,000
Investments	25,000
Deferred	30,000
Total	$1,097,000
Notes payable, 5%	$ 48,000
Accounts payable	91,350
Accruals	18,650
Mortgage payable, 6%	50,000
Reserve for depreciation	39,000
Preferred stock, $100 par issued and outstanding	500,000
Common, no par, $10 stated value outstanding	300,000
Surplus	50,000
Total	$1,097,000

Other data for forecast for six months ending December 31:

Sales, costs and operating expenses estimated at one-half of the amounts shown by forecasts for the full year. Accounts receivable increase $25,000 after allowance of $1,500 sales discounts; reserve for bad accounts on same basis as for first six months. Purchase discounts for the remainder of the year estimated at $3,000. Raw material purchases to replace amount included in cost of sales; accounts payable reduced $30,000; inventory, accrued expenses (other than interest) and deferred items to remain unchanged from June 30 balances.

NOTE: Disregard federal income taxes.

THE OHIO STATE BOARD OF ACCOUNTANCY

PRACTICAL ACCOUNTING

Examination, November, 1938

By agreement, the stockholders of the A Corporation and the B Corporation organized the D Corporation under the laws of the state of Ohio for the purpose of acquiring the assets and assuming the liabilities of these two corporations as of October 31, 1938, and to increase the annual earnings estimated to equal $603,000.

The authorized capital of D Corporation consisted of the following:

20,000 shares, cumulative, nonparticipating, Class A 5 per cent preferred stock, par value $100
10,000 shares, cumulative, nonparticipating, Class B 3 per cent preferred stock, par value $100
10,000 shares no par common having a stated value of $1,000,000

There was also authorized an issue of $1,000,000 second-mortgage 4 per cent bonds, interest payable April 30 and October 31.

In accordance with the merger plan, the stockholders in the old companies are to receive stock and bonds in the new corporation as follows:

(*a*) Second-mortgage bonds for the goodwill and fixed assets, less fixed liabilities.
(*b*) Class A preferred stock for the net working capital, including intercompany accounts.
(*c*) Class B preferred stock for all other assets, including the investment in C Corporation at its present market value of $95 per share.

(*d*) No-par common stock for (x) the excess earnings over bond interest and preferred stock dividend requirements for each of the groups of stockholders; plus (y) the expected increase of $105,000 in the annual earnings distributed in proportion to each of the corporations' effectiveness expressed in the rate of average earnings based on average net worth. (For the purpose of this problem, assume the average to be the net worth shown by the balance sheets submitted on the following page.) The totals of (x) and (y) to be multiplied by two to obtain the amount of common stock to be issued to each group of stockholders.

Your audit of the books of A Corporation, B Corporation and C Corporation for the five years ended October 31, 1938, disclosed the following conditions:

With respect to A Corporation the average annual earnings for the past five years amounted to $390,000. The 8,000 shares of stock in C Corporation was acquired November 1, 1937, at the then market price of $90 per share, par value being $100 per share. A cash dividend of $8,000 was received from the subsidiary November 8, 1937, and credited to the investment account. Inventories on hand at October 31, 1938, included merchandise purchased from C Corporation for a price which was $5,000 in excess of the subsidiary's cost.

With respect to B Corporation the average annual earnings for the past five years amounted to $108,000.

With respect to C Corporation the federal income tax of $16,000 for the year ended October 31, 1938, had not been entered on the books. The deferred charges at that date should be increased $1,200. No provision had been made for accrued interest on the mortgage for the last half of the fiscal year. The minutes of a directors' meeting October 18, 1938, authorized a 2 per cent dividend payable November 15, 1938. The company began business November 1, 1936. The earnings for the first year ended October 31, 1937, amounted to $110,000 and according to the books, the earnings for the year ended October 31, 1938, amounted to $88,000.

The balance-sheets of the three corporations, as taken from the books, are presented below.

Assets	A Corporation	B Corporation	C Corporation
Cash	$ 100,000	$ 75,000	$ 50,000
Notes receivable, customers	50,000	40,000	10,000
Notes receivable, Corporation B	100,000		
Notes receivable, Corporation C	25,000		
Accounts receivable:			
Customers	220,000	100,000	150,000
Corporation B	30,000		
Corporation C	80,000		
Inventories	400,000	200,000	300,000
Investment in Corporation C (8,000 shares par $100, cost $90)	712,000		
Plant and equipment, depreciated	200,000	750,000	1,000,000
Goodwill	100,000		50,000
Deferred charges	18,000	20,000	5,000
Totals	$2,035,000	$1,185,000	$1,565,000
Liabilities, Capital and Surplus			
Notes payable to banks	$ 21,000		$ 50,000
Notes payable to Corporation A		$ 100,000	25,000
Accounts payable:			
Trade	40,000	62,000	20,000
Corporation A		30,000	80,000
Accrued taxes and payroll	24,000	23,000	2,000
Mortgage payable, bank (5%)		250,000	200,000
Common stock	1,500,000	800,000	1,000,000
Surplus (*deficit*)	450,000	(*80,000*)	188,000
Totals	$2,035,000	$1,185,000	$1,565,000

Required:

Working sheet:

1. Stock and bond allotment in merger of A Corporation and B Corporation.
2. (*a*) Merger of A Corporation and B Corporation into D Corporation

   (*b*) Consolidation of D Corporation and C Corporation

Consolidated balance-sheet of D Corporation and its subsidiary C Corporation showing minority interest.

THE OHIO STATE BOARD OF ACCOUNTANCY

COMMERCIAL LAW

Examination, November, 1938

1. (*a*) The Ohio Unemployment Insurance Law requires each employer subject to the act to pay contributions on wages payable by him at the rate of 2.7 per cent for 1938. The Federal Unemployment Insurance Law requires each employer subject to the act to pay on the total wages payable by him at the rate of 3 per cent for 1938. If the taxable wages of an employer for 1938 amounted to $500,000, what is the total amount of unemployment insurance tax he would be expected to pay? (*b*) The Old Age Benefit tax rate for 1938 is 1 per cent for each, the employer and the employee. Assuming the wages of $500,000 above were analyzed as follows, how much tax would be paid by both the employer and employees during 1938:

> Officers' salaries (3 at $30,000), $90,000; employees over 65 years of age, $50,000; other taxable wages, $360,000.

2. State whether or not the following items are deductible in computing a corporation's taxable net income: (*a*) legal services for incorporation, (*b*) contributions to community chest fund, (*c*) loss on sale of stock of another corporation, (*d*) loss on sale of corporation's own preferred stock and (*e*) purchase of goodwill.

3. In the preparation of county return of personal and intangible property, state how the following items are listed by a corporation manufacturing products in this state: (*a*) inventories; (*b*) stocks owned in other corporations; (*c*) office supplies; (*d*) credits; (*e*) machinery and equipment in use, fully depreciated; (*f*) machinery and equipment in use not fully depreciated; (*g*) interest received on bonds owned in other corporations; (*h*) deposits in financial institutions outside the state, withdrawable only by officer or agent having an office in such other state.

4. (*a*) May titles to certificates of stock be transferred by one owner to another by delivery of the certificates endorsed in blank and by stock power? (*b*) What is meant by a voting trust?

5. (*a*) What is the purpose of the Ohio Blue Sky Law? (*b*) What is the function of the Federal Securities and Exchange Commission?

6. If shares of stock in an Ohio corporation which by the articles are subject to redemption are redeemed in accordance therewith, is it necessary to file a certificate of reduction with the secretary of state? If the shares so redeemed were cancelled, would your answer be the same?

7. (*a*) What are *ultra vires* acts of a corporation? (*b*) The charter of the Ohio Corporation does not confer upon it in express terms the right to acquire and hold real property except for its manufacturing plant. Has the corporation the power to purchase a large office building, occupy the ground floor for its general offices and lease the rest of the building to tenants? Why?

8. (*a*) Name three acts of bankruptcy. (*b*) A corporation's balance-sheet as of December 31, 1937, showed total assets of \$2,000,000, total liabilities of \$2,100,000, outstanding capital stock of \$500,000 and a deficit of \$600,000. On January 3, 1938, accounts receivable included among the assets amounting to \$150,000 were assigned to a creditor in full settlement of the debt owing that creditor. On the same date a \$2,000,000 contract was obtained the completion of which was guaranteed to be not later than September 1, 1938, and the profit on which was estimated at \$750,000. On July 1, 1938, one of the principal creditors filed a petition of bankruptcy against A corporation. What was the basis of the petition, and what was the defense?

9. (*a*) What is a power of attorney? (*b*) A power to hypothecate? (*c*) The examination of collateral loans in a financial institution revealed a loan signed by John Doe, secured by 500 shares of General Motors stock issued to Richard Roe. The stock was not endorsed. What authority would you expect the bank to have to protect its loan?

10. (*a*) What are the essential elements of a valid contract? (*b*) A negotiable instrument?

AMERICAN INSTITUTE OF ACCOUNTANTS

BOARD OF EXAMINERS

EXAMINATION IN AUDITING

November 17, 1938, 9 a.m. to 12:30 p.m.

[*The candidate must answer all questions.*]

No. 1 (5 points):

How should the following items be shown on the balance-sheet?

1. Goods ordered but not received.
2. Goods received but not yet entered on books.
3. Goods held on consignment.
4. Goods out on consignment.
5. Goods sold for future delivery.

No. 2 (5 points):

Under what headings should the following credit items appear on a balance-sheet?

1. Reserve for depreciation.
2. Reserve for contingencies.
3. Reserve for bad debts.
4. Reserve for collection expenses.
5. Reserve for damages in law suit (adverse decision).
6. Reserve for patent litigations (pending).
7. Reserve for federal income taxes.
8. Reserve for reduction of inventory values.
9. Premiums received on capital stock.
10. Premiums received on bonds.
11. Bond sinking fund.
12. Pension fund.

No. 3 (5 points):

What should the auditor look for when examining the minutes of the board of directors of a corporation in connection with an audit of its accounts?

Name at least six important matters.

No. 4 (5 points):

In the audit of a corporation it was found that during the year $100,000 bonds of a serial issue had become due. The company had bought the bonds at par from its treasurer who, acting also as agent for the other officers of the company, had acquired them from individual bondholders at much lower prices. The bonds were then turned over by the company to the trustee for cancellation as stipulated under the provisions of the trust deed. The officers divided the profit among themselves. The trust deed does not cover the foregoing points.

How will you deal with this (a) if the officers own all the stock of the corporation and (b) if the officers do not own all the stock?

No. 5 (5 points):

A manufacturing company has capitalized overhead on the construction of machines and equipment made in its own machine shop and for its own use.

To what extent, if at all, should overhead be included?

No. 6 (10 points):

Briefly explain the meaning of the following terms as used in governmental accounting.

1. Fund
2. Budgetary accounts
3. Appropriation
4. Encumbrance
5. Unappropriated surplus

No. 7 (10 points):

The X Company sold bonds of the par value of $1,000,000 on January 1, 1935. The bonds were due serially $100,000 on December 31, 1935, and annually thereafter. Interest is payable at the rate of 5% semi-annually on June 30th and December 31st of each year. The bonds refer to a trust indenture naming the Y Trust Company as trustee. All principal and interest payments to the bondholders are specified to be made by the trust company, and the indenture also states that the X Company shall pay all maturing principal and interest amounts to the trustee on the due dates.

On June 30, 1935, the company paid $25,000 to the trustee and charged this amount to interest. On December 31, 1935, the company paid $125,000 to the trustee and charged $100,000 to the bond account and $25,000 to interest.

You are the auditor of the X Company and have received confirmation from the trustee as of December 31, 1935, stating that interest coupons maturing June 30, 1935, have been paid in the amount of $23,900, and interest coupons maturing December 31, 1935, have been paid in the amount of $800; also that bonds maturing December 31st have been paid in the amount of $13,000. The trustee also reports that he has on hand a cash balance in favor of the X Company in the amount of $112,300. The canceled bonds and coupons referred to by the trustee had been returned to the company and were inspected by you.

How will you treat the outstanding bonds, interest coupons and cash balance in the hands of the trustee in the company's balance-sheet of December 31, 1935?

No. 8 (10 points):

What would be your procedure in an audit of a partnership if your examination disclosed that

1. The division of profits and the capital contributed by each does not agree with the partnership agreement.
2. A partner had died in the year under examination, but no recognition of this fact was shown on the books.
3. A partner had sold his share during the year to one of his copartners, but this sale was not reflected in the accounts.
4. A new partner was admitted during the year.

No. 9 (10 points):

The Expansive Construction Company contracted to build 100 railway cars of the same type for $2,500 each, payable as the cars were delivered. At the date of audit construction costs of $199,500 had been charged to contract work in progress and 75 of the units had been delivered and charged to the customer. The remaining 25 units were alleged to be 80% complete.

1. Outline a program for verification of the balance in the contract work in progress account.
2. Indicate how the above-given data should be shown on the balance-sheet and the profit-and-loss account.

No. 10 (15 points):

An interurban railway company sells books of tickets that are accepted as fares. The books are sold to the public at the office and by the conductors. The cashier has charge of the ticket books, sells them at the office and supplies the conductors.

At the end of each run the conductor prepares a report of the total receipts as recorded on the fare register, showing the make-up of this total in cash fares and tickets, and of the ticket books sold. This report, together with the cash and tickets collected, are turned over to the cashier. The latter checks the conductor's report with the cash and tickets received, turns the report over to the auditor and the cash and tickets to the treasurer.

Outline a system of internal check that will insure the proper handling of cash receipts and tickets by the cashier.

No. 11 (20 points):

The Alchemy Corporation manufactures chemicals and delivers its finished products in returnable drums. To insure that no loss will be sustained by failure of the customer to return the drum a charge of $15 each, whether the drums are new or old, is billed to the customer. It is the general practice of most customers to remit cash for only the value of the contents and to return the drums for credit. Occasionally, however, the amount charged for the drums is also remitted by the customer and in some instances these drums are never returned for credit.

1. Show in the form of journal entries how the following transactions and conditions should be recorded in the accounts of the Alchemy Corporation:
   (a) Original purchases of drums
   (b) Drums billed to customers
   (c) Drums returned
   (d) Drums not recoverable from customers and for which the charges cannot be collected
2. What accounts should be kept in the general ledger and how should they be shown on the balance-sheet?
3. What detailed or over-all checks can be made to verify the balances in these ledger accounts?

AMERICAN INSTITUTE OF ACCOUNTANTS

BOARD OF EXAMINERS

EXAMINATION IN ACCOUNTING THEORY AND PRACTICE—PART I

November 17, 1938, 1:30 p.m.

[*The candidate must solve all problems.*]

No. 1 (30 points):

The following trial balance of the Atlantic Seaboard Lumber Company, dated December 31, 1937, is submitted:

	Dr.	*Cr.*
Cash in banks and on hand	$ 45,900	
Accounts receivable—customers	75,650	
Reserve for freight allowances		$ 4,300
Reserve for doubtful accounts		3,500
Standing timber—Tract 1	1,200,000	
Standing timber—Tract 2	500,000	
Reserve for depletion—Tract 1		70,500
Lumber inventory, December 31, 1937	80,000	
Logs in pond, December 31, 1937	1,250	
Material and stores inventory, December 31, 1937	7,500	
Land	5,000	
Buildings and structures	47,000	
Machinery and equipment	140,000	
Transportation equipment	175,000	
Reserve for depreciation		28,710
Prepaid insurance and taxes	4,310	
Accounts payable		11,850
Accrued wages		4,750
Capital stock—6 per cent preferred, noncumulative, $100 par		1,200,000
Capital stock—common, $5 par		900,000
Sales of lumber		565,000
Manufacturing cost of lumber sold	398,000	
Shipping expenses of finished lumber	50,000	
Selling expenses	30,500	
General and administrative expenses	28,500	
Totals	$2,788,610	$2,788,610

The company began business on January 1, 1937, with a capital of $2,100,000, representing cash received for 12,000 preferred shares of $100 each and 180,000 common shares of $5 each. Two uncut timber tracts and the necessary land, buildings and equipment to carry on a lumber business were purchased. An independent cruise showed an estimate of 400,000,000 and 250,000,000 board feet (log scale) on tracts 1 and 2 respectively as available for cutting.

The company valued its closing inventories of finished lumber and logs in pond at average cost per thousand feet produced during the year, irrespective of grades. These inventories, the production for the year and the selling prices per thousand feet prevailing during the year are shown, as follows:

Grade	M Feet Board Measure *Inventory*	M Feet Board Measure *Production*	Selling Price per M Feet
A	600	7,200	$35
B	500	6,000	30
C	400	4,800	25
D	1,600	3,600	20
E	600	1,800	15
F	300	600	10
Totals	4,000	24,000	
	M Feet Log Scale		
Logs in pond	100	23,500	

Material and stores were correctly valued at the lower of cost or market.

The company used 100,000 feet of its grade D lumber in the building of a storehouse and charged $2,000 to building and structures account.

The following cost data covering the year's operations were extracted from the records:

		Per M Feet Log Scale	M Feet
Logging operations:			23,500 Log scale
Stumpage	$ 70,500	$ 3 00	
Cutting	47,000	2.00	
Skidding	23,500	1.00	
Spur tracks	23,500	1.00	
Railroad operation	47,000	2.00	
Totals	$211,500	$ 9.00	

Loading operations:			
Loading to lighters	$ 23,500	$ 1.00	
Towing to mill	58,750	2.50	
Totals	$ 82,250	$ 3.50	
Totals	$293,750	$12.50	
Less—Logs in pond 12/31/37	1,250		100 Log scale
Balance	$292,500		23,400 Log scale
Over-run on basis of actual board measure			600
Cost of logs to sawmill	$292,500	$12.1875	24,000 Board measure
Mill operations:			
Unloading at mill	$ 31,500	$ 1.3125	
Sawmill	96,000	4.00	
Sorting shed	24,000	1.00	
Lumber yard	36,000	1.50	
Totals	$187,500	$ 7 8125	
Total cost of production	$480,000	$20 0000	24,000 Board measure

The reserves for freight allowances and doubtful accounts appear adequate, the fixed-asset accounts have been verified, adequate depreciation has been provided, and all ascertainable liabilities outstanding at December 31, 1937, had been brought upon the books as of that date.

Prepaid insurance and taxes include a charge of $2,500 representing the year's real-estate taxes applicable to tract No. 2. Logging operations will not commence on this tract until several years hence.

From the foregoing information, prepare:

1. A balance-sheet as at December 31, 1937, showing the closing inventory of finished lumber valued by apportioning the production costs to the several grades on the basis of their sales values.
2. A statement of profit and loss for the year ended on that date.

State briefly why the aforestated method of inventory valuation should be used. Income-tax features in connection with this problem are to be ignored.

No. 2 (30 points):

The Portland Cement Company proposes to acquire all of the outstanding stock of the Industrial Cement Company. An

investigation of the fixed assets by independent engineers shows that the land, buildings and equipment are conservatively valued. However, the rock deposits which were depleted on the basis of 60,000,000 tons commercial quantity should have been depleted on the basis of 30,000,000 tons. Up to the end of the year 3,000,000 tons of rock had been quarried.

The inventory is correct as to quantities, and the Industrial Cement Company's cost system determines the cost of the raw materials and finished cement on the basis of the previous month's inventory valuation plus the current month's production cost. This method resulted in high inventory valuation for the reason that during the last three months of the year production was materially curtailed and extensive repairs were made. The Industrial Cement Company agrees that the opening as well as the closing inventories are to be revalued on the basis of the year's production cost and that an adjustment of the depletion reserve should be made.

The Portland Cement Company submits the following December 31, 1937, balance-sheet of the Industrial Cement Company:

Assets

Current assets:		
Cash		$ 500,000
Notes and accounts receivable—less $45,000 reserve		200,000
Inventories:		
Materials and supplies	$ 180,000	
Cement in process and in bins	202,500	382,500
Total current assets		$1,082,500
Fixed assets:		
Buildings and equipment—less $1,000,000 reserve	$2,000,000	
Land	7,500	
Rock deposits—less $30,000 reserve	570,000	
Total fixed assets		2,577,500
Deferred charges		50,000
Total		$3,710,000

Liabilities

Current liabilities		$ 200,000
Capital:		
Capital stock	$2,800,000	
Earned surplus	710,000	3,510,000
Total		$3,710,000

In addition to the foregoing balance-sheet the following information is given:

	Inventories			
	January 1, 1937		December 31, 1937	
	Quantity	*Amount*	*Quantity*	*Amount*
Rock—tons	20,000	$ 7,000	10,000	$ 5,000
Slurry—bbls	16,000	6,400	10,000	7,500
Clinker	40,000	36,000	70,000	70,000
Cement	70,000	77,000	100,000	120,000
Total		$126,400		$202,500

The departmental production cost for the year ended December 31, 1937, including depreciation and depletion, is as follows:

Rock	$ 60,000
Slurry	158,100
Clinker	530,000
Finish grind	206,000
Total	$954,100

The Industrial Cement Company sold during the year 1,000,000 barrels of cement. It has been that company's experience to obtain 3.4 barrels of cement out of each ton of rock.

The rock is transferred to the slurry, the slurry to the clinker and the clinker to the finish grind, producing cement.

Prepare:

1. A work sheet showing computations.
2. A comparative statement showing the departmental production costs (1) per books and (2) adjusted to the revalued inventories.
3. A computation of the adjusted book value of the common stock of the Industrial Portland Cement Company.

No. 3 (25 points):

On January 1, 1936, Dr. John Smith and Dr. David Jones formed a co-partnership to be known as Drs. Smith and Jones, Physicians and Surgeons. The firm succeeded to the practice which had heretofore been conducted by Dr. Smith as an individual. The only assets acquired by the firm from Dr. Smith were certain furniture and fixtures which by mutual agreement were valued at $3,000.

The partnership agreement provides:

1. For the year 1936 the profits and losses shall be shared in the ratio of 64% to Dr. Smith and 36% to Dr. Jones. Each year thereafter Dr. Jones' share in the firm's profits and property increases 1% until a 50% interest is reached.
2. Dr. Smith is to receive an annual payment for furniture, fixtures and equipment contributed by him to the firm equal to the depreciation thereon.
3. The accounts are to be kept on a cash basis and immediately after the close of each calendar year an accounting is to be made of the preceding year's affairs on said cash basis; each partner is to receive in cash, to the extent available, his distributive share of the net income.

The following condensed trial balances are submitted:

	December 31, 1936		December 31, 1937	
	Dr.	*Cr.*	*Dr.*	*Cr.*
Cash	$ 4,510		$ 4,220	
Accounts receivable—patients	10,000		8,000	
Contingent professional income		$10,000		$ 8,000
Furniture and fixtures—Dr. Smith	3,000		3,000	
Furniture and fixtures—firm	1,200		3,700	
Reserve for depreciation—Dr. Smith		300		300
Reserve for depreciation—firm		60		60
Dr. Smith—Personal capital		3,000		2,700
Dr. Smith—Fixed capital		768		768
Dr. Smith—Current account		2,176	12,600	
Dr. Jones—Fixed capital		432		432
Dr. Jones—Current account		1,974	6,000	
Totals	$18,710	$18,710		
Professional income				39,000
Total expenses			13,740	
Totals			$51,260	$51,260

Depreciation on furniture and fixtures is to be computed at the rate of 10% per annum; additions during the year on an average of six months. No interest on partners' balances or drawings is to be considered.

From the foregoing data prepare:

1. The entries adjusting the accounts and distributing the cash.

2. The usual columnar work sheet showing the trial balance after the December 31, 1937, final settlement.

No. 4 (15 points):

On October 1, 1928, the Lee Publishing Company entered into a special royalty contract for the publication of a book on a religious subject, the royalty of $40 a hundred to be paid on or before October 1, 1934, on a minimum publication of 50,000 copies. It was stipulated that in the interval the payments were to be made from time to time as the books were bound and ready for sale. The publishing company proceeded to print the minimum number of sheets and included the royalty in the sheet cost, setting up the liability therefor. Up to October 1, 1934, the royalty had been paid as agreed on the basis of 13,500 copies bound, and the balance on the remaining 36,500 copies became due.

However, owing to the slowness of the sale of the book, it was agreed on the latter date that the original contract was to be modified for the balance of the royalties and negotiations commenced to fix the new terms. The publishing company, having on hand 2,840 copies of bound stock, then also decided to write off against its surplus all the royalty included in its inventories.

During the years 1935 and 1936 there were 1,300 additional copies sold and on December 31, 1936, there remained in the hands of the publisher 1,540 bound copies, but no further sheet stock had been bound. On that date a final arrangement was made whereby the remaining royalty liability was settled and paid at 50 cents on the dollar. Thereupon the publishing company, in view of a revived demand for the publication, reinstated as a deferred charge the advance royalty actually paid on the stock in hand.

1. Submit a summary of royalty liability account showing the above transactions and the final settlement.
2. Submit the journal entry recording the adjustment of October 1, 1934, inventories.
3. Submit the journal entry setting up the advance royalty at December 31, 1936, as a deferred charge.

AMERICAN INSTITUTE OF ACCOUNTANTS

BOARD OF EXAMINERS

EXAMINATION IN COMMERCIAL LAW

November 18, 1938, 9 a.m. to 12:30 p.m.

Reasons must be stated for each answer. Whenever practicable give the answer first and then state reasons. Answers will be graded according to the applicant's evident knowledge of the legal principles involved in the question, rather than on his conclusions.

GROUP I

Answer all questions in this group.

No. 1 (10 points):

The legal holder of a properly drawn check presented it to the bank on which it was drawn and demanded that the bank certify it, which the bank refused to do. At no time was the check presented for payment, but within what would have been a reasonable time for such presentation the holder formally notified the drawer that certification had been refused and demanded that the drawer pay the amount of the check. On the facts stated, must the drawer immediately pay the holder?

No. 2 (10 points):

Two men were legally engaged in an unincorporated business under the duly recorded assumed name of The Atlantic Company without any written agreement, and it became necessary to determine whether they were partners. One had invested cash in the business and the other had lent his credit to it and had assisted in the management of it. What documents would you examine and for what other facts would you inquire as apt to have significant bearing on the question?

No. 3 (10 points):

A person, although not admitted to the bar, is permitted to act as his own attorney in court proceedings by or against him. Can the president, or any other officer of a corporation, when duly authorized by the board of directors, act as attorney for the corporation in court proceedings by or against it?

No. 4 (10 points):

An accountant's secretary, in transcribing her notes, erroneously wrote to a prospective client that the per diem charge for a senior accountant was $25 (instead of $35, which had been dictated to her) and she signed the accountant's name and mailed the letter. The client immediately wrote to the accountant engaging him "at the rates specified in your letter." The accountant satisfactorily performed the work and now seeks to charge the client $35 per diem, which is the prevailing rate, of which the client was fully aware at all times. Can the accountant succeed?

No. 5 (10 points):

A stationery supply store voluntarily, and without request by the accountant, delivered by messenger to the accountant's office a package of analysis paper, together with a sealed envelope containing a letter stating that the paper was to be paid for at the price stated or returned within 10 days. The package and letter were accepted as a matter of routine by the accountant's reception clerk, who did not know and had no way of knowing their contents. Is the accountant under any legal obligation to answer the letter or to return the package if he makes no use of the analysis paper?

Group II

Answer any five questions in this group. No credit will be given for additional answers, and if more are submitted only the first five will be considered.

No. 6 (10 points):

List or enumerate, but do not discuss, the provisions in the bankruptcy law which became effective September 22, 1938, concerning plans of corporate reorganization, stating with what

a plan may deal, for what it may and for what it must provide, and what it must specify.

No. 7 (10 points):

A promissory note, properly dated and signed, read as follows: "One year from date, for value received, I promise to pay to the order of the Mercantile Bank the sum of two hundred sixteen dollars ($216), there having been deposited herewith as collateral security pass book No. 15043 issued by your compound-interest department in my name, and I agree to deposit in said compound-interest account the sum of eighteen dollars ($18) on the fifteenth day of every month hereafter until a total of the face amount of this note shall have been deposited." Is this note negotiable?

No. 8 (10 points):

A woman delivered to her broker a certificate, endorsed in blank, for seventy shares of a corporation's stock, with oral instruction to sell when directed. The broker gave her a written receipt without reservation of power or qualification. The broker placed the shares in various quantities in the names of several nominees to facilitate prompt sale, and accounted to the owner for all dividends. Later, the owner decided not to sell, but requested the return "of her stock certificate," and a new certificate for seventy shares was delivered to her. She seeks to hold the broker responsible for the amount of a drop in market value between the date when the stock was placed in the names of the nominees and the date when the new certificate was delivered to her. Upon what theory does she base her claim, and can she succeed in enforcing it?

No. 9 (10 points):

On December 1, 1937, a client procured fire insurance on a small warehouse for three years and paid the premium in advance. He now is about to sell the warehouse. What would you advise him to do with respect to the unexpired insurance?

No. 10 (10 points):

1. Define specific performance.
2. In what circumstances, if any, can a buyer of personal property legally demand specific performance of the contract by the seller?

No. 11 (10 points):

With respect to capital gains and losses under the federal revenue act of 1938:

1. Define "short term."
2. Define "long term."
3. Into what classes or groups are long-term gains and losses subdivided, and what percentage of the net in each class or group can be taken into account?
4. Assume that an individual's net income and, in addition thereto, his short-term gains and losses were as follows:

	Net Income	Short-Term Gains	Short-Term Losses
1938	$22,000	$15,000	$40,000
1939	28,000	30,000	10,000
1940	24,000	12,000	10,000

Assuming no facts or figures other than the foregoing, upon what amounts will his 1938, 1939, and 1940 income taxes, respectively, be computed?

No. 12 (10 points):

The statutes of a state impose a tax upon the net income of a corporation, but permit proration of the net income when the entire business of the corporation is not transacted within the state. The net income is to be divided into thirds, each of which is to be apportioned by multiplying it by a fraction to determine the portion attributable to business within the state. The fractions to be used are the following:

Numerator

1st third—Value of tangible property within state.
2nd third—Compensation to employees within state.
3rd third—Gross receipts from business within state.

Denominator

1st third—Value of all tangible property.
2nd third—Compensation to all employees.
3rd third—Total gross receipts.

If only two of the foregoing fractions are applicable, the net income is to be divided into halves and each fraction applied

once to one half. If only one is applicable, that fraction is applied to the entire net income. A fraction is not inapplicable merely because all of the tangible property, all of the compensation, or all of the gross receipts were situated, paid, or received without the state.

Assuming a net income of $120,000, state the amount attributable to business within the state in each of the following situations:

	Tangible Property	
	Within State	*Without State*
(a)	None	None
(b)	None	$ 75,000

	Compensation to Employees	
	Within State	*Without State*
(a)	$ 40,000	$ 20,000
(b)	30,000	30,000

	Gross Receipts	
	Within State	*Without State*
(a)	$450,000	$150,000
(b)	400,000	100,000

AMERICAN INSTITUTE OF ACCOUNTANTS

BOARD OF EXAMINERS

EXAMINATION IN ACCOUNTING THEORY AND PRACTICE—PART II

November 18, 1938, 1:30 p.m.

[*The candidate must solve all problems.*]

No. 1 (30 points):

You are visited during the morning of December 31, 1937, by Mrs. Yolande Zeno, executrix and sole beneficiary of the estate of her deceased husband, X. Y. Zeno, who submits the following statements:

ESTATE OF X. Y. ZENO
Trial Balance
December 30, 1937

Cash	$ 2,850	
The Xenophon Corporation stock—4,375 shares	28,000	
N. Y. Central R. R. stock—120 shares	4,800	
U. S. Sorghum Company stock—2,000 shares	32,000	
U. S. Treasury notes—$56,000 face value	56,000	
Allowed claims—including interest accrued to December 31, 1937:		
First National Bank—loans to testator		$ 48,000
County treasurer—taxes		4,000
Yolande Zeno—loans to testator		300,000
Theophilus Zeno—loans to testator		24,000
The Xenophon Corporation—loans to testator		96,000
The Xenophon Corporation—funds advanced for funeral expenses		6,000
William Jones—merchandise sold to testator		12,000
Smith & Brown—services as counsel to executrix		54,000
Deficiency	420,350	
Totals	$544,000	$544,000

THE XENOPHON CORPORATION
Trial Balance
December 30, 1937

Cash	$ 2,750.00	
Lima Bean Company stock—3,600 shares	85,394.73	
Claims against Estate of X. Y. Zeno	102,000.00	
Capital stock—5,000 shares		$100,000.00
Surplus		89,794.73
Accounts payable—Smith & Brown		350.00
Totals	$190,144 73	$190,144.73

Mrs. Zeno is the president of The Xenophon Corporation and the owner of 625 shares of its stock and states that during the morning the following transactions took place:

First: The court administering the estate of her deceased husband ordered her:

1. To accept certain offers, namely:
   $2,400 for 120 shares N. Y. Central R. R.,
   $123,650 for 2,000 shares U. S. Sorghum,
   $56,400 for $56,000 face value treasury notes,
   and deliver these securities for cash;
2. To pay in full the indebtedness to Xenophon Corporation and the preferred claims against the estate;
3. To submit to the court at its next session a charge and discharge statement, showing also the payments to be made to the other creditors of the estate and reserving an amount sufficient to pay 12½% profits tax in the event that the court finds the estate liable therefor despite its insolvency.

Second: The Xenophon Corporation sold its 3,600 shares of Lima Bean stock for $8,000 cash and, pursuant to appropriate resolution of its stockholders and directors, paid its debts and credited its shareholders with their proportion of the net worth.

Mrs. Zeno states that she has complied with the first two requirements of the court order, and asks your assistance with the third. You may assume that the only tax provision necessary is 12½% of the net gain from realization of the assets listed in the trial balance.

Prepare (a) the required charge and discharge statement, together with the work sheets showing (b) the position of the

estate after complying with the court orders and (c) the position of the Xenophon Corporation after crediting the shareholders with their proportion of the net worth.

No. 2 (30 points):

The Producing Company submits the following balance-sheet dated June 30, 1938:

Assets	
Current assets	$2,000,000
Fixed assets, less reserves	2,500,000
Intangible assets	3,000,000
Organization expenses	500,000
Deferred charges	100,000
Total	$8,100,000
Liabilities	
Current liabilities	$ 500,000
Preferred stock—8% cumulative 400,000 shares of $10 each	4,000,000
Common stock 300,000 shares of $10 each	3,000,000
Earned surplus	600,000
Total	$8,100,000

The common stock was issued for the intangible assets acquired at organization.

The company had been in existence for a period of five years but paid no preferred dividends so that on June 30, 1938, an amount of $1,600,000 was in arrears. In order to liquidate this obligation and properly restate the accounts, the board of directors had previously submitted a plan of recapitalization, to take effect on June 30, 1938, which was accepted by all the shareholders, viz.:

1. The company is to amend its articles of incorporation and change its capital structure so that the recapitalization may take effect as at June 30, 1938, as follows:
   (a) The authorized capital will be $5,100,000 consisting of 480,000 shares 4% preferred of $10 each and 300,000 shares common of $1 each. The preferred shares may be made either cumulative, non-participating or non-cumulative participating.
   (b) The 8% preferred shareholders are to relinquish all claims for dividends for which they are to receive 50%

of the amount of their claims in new preferred stock at par value.

(c) The 8% preferred shareholders have up to December 31, 1940, the option to exchange their shares and reduced dividend claims par for par either for 4% cumulative, non-participating preferred with dividends cumulative from June 30, 1938 on, or for 4% non-cumulative, participating preferred shares. The non-cumulative shares will participate equally with the common shares in the earnings after June 30, 1938, that are in excess of the preferred-dividend requirements, up to 30% of this excess.

(d) The par value of the common shares will be reduced from $10 to $1 a share.

2. The Company is to declare a dividend of 20 cents, payable on July 15, 1938, on the 4% cumulative non-participating preferred shares.

On July 1, 1938, holders of ninety per cent of the 8% preferred shares elected to take the 4% cumulative non-participating shares and holders of the remaining ten per cent to postpone their choice.

1. Prepare a balance-sheet as at June 30, 1938, after giving effect to the recapitalization plan.
2. Prepare the entries that are to be made on December 31, 1940, in the event that holders of 30,000 shares 8% preferred elect, between June 30, 1938, and December 31, 1940, to exchange them for 4% cumulative preferred and the holders of the remaining 10,000 shares to take 4% non-cumulative shares. Suppose that no preferred dividends have been paid or declared since July 15, 1938.

No. 3 (15 points):

From the following trial balance of the Anderson Company and the accompanying data prepare a columnar work sheet showing the adjustments and the segregation of balance-sheet and profit-and-loss items.

ANDERSON COMPANY
Trial Balance
December 31, 1937

	Dr.	Cr.
Cash in banks	$ 180,000	
Petty cash funds	5,000	
Customers' notes receivable	80,000	
Accounts receivable	900,000	
Current advances to subsidiary companies	25,000	
Investment in subsidiary companies	500,000	
Land	5,000	
Buildings	20,000	
Machinery and equipment	50,000	
Furniture and fixtures	40,000	
Reserve for depreciation at January 1, 1937		$ 35,000
Life insurance	200,000	
Inventory at January 1, 1937	500,000	
Trade creditors		220,000
Common stock ($100 par) authorized and issued		500,000
Surplus at January 1, 1937		960,000
Net sales		5,800,000
Purchases	3,500,000	
Manufacturing expenses	400,000	
Selling, administrative and general expenses	1,150,000	
Other income		40,000
Totals	$7,555,000	$7,555,000

During the examination the following facts are disclosed:

1. Checks totaling $10,000 in settlement of accounts payable were dated and issued in December 1937 but not entered in the cash book until January 1938.
2. Accounts receivable include an amount of $400,000 representing capital advances to subsidiary companies. The balance is receivable from customers.
3. It is estimated that 10% of the customers' accounts receivable and 10% of the notes receivable are doubtful of collection. All accounts and notes were considered collectible at the beginning of the year.
4. The inventory at January 1, 1937, includes the following:

Machinery and equipment	$200,000
Less—Reserve for depreciation	100,000
Balance	$100,000

5. The inventory at December 31, 1937 (excluding machinery and equipment and the relative reserve) is as follows:

Inventory on hand	$500,000
Inventory in transit for which the liability has not been recorded	10,000
Total	$510,000

6. The amount shown as life insurance represents the accumulated premiums which were charged to this account. The premiums paid to December 31, 1936, amounted to $160,000 and the premiums paid in 1937 amounted to $40,000. An examination of the policies shows that the cash surrender value at December 31, 1936 amounted to $85,000 and the cash surrender value at December 31, 1937 amounted to $100,000.
7. There has been no change in the various property accounts during 1937. Depreciation should be provided at the following rates:

Buildings	5% per year
Machinery and equipment	10% " "
General office furniture and fixtures	10% " "

8. Insurance premiums, charged to general expenses:

Prepaid at December 31, 1936	$3,000
Prepaid at December 31, 1937	2,000

9. Taxes, charged to general expenses:

Prepaid at December 31, 1936	$5,000
Prepaid at December 31, 1937	8,000

10. Commissions, charged to selling expenses:

Accrued at December 31, 1936	$4,000
Accrued at December 31, 1937	5,000

Inventories, fixed assets and investments are shown throughout at cost.

Income taxes are not to be considered.

No. 4 (15 points):

From the following audited trial balance of a municipality prepare its December 31, 1937 balance-sheet showing the division into the several funds:

Debits

Accounts receivable (general)	$ 461,000
Cash, general fund	619,000
Cash, expendable trust fund	171,000
Cash, permanent trust fund	1,000
Cash, bond fund	1,762,000
Rentals receivable (general)	221,000
Fixed assets, general	292,623,000
Fixed assets, water department	84,093,000
Investments, expendable trust funds	12,513,000
Investments, permanent trust funds	1,262,000
Investments, sinking funds	25,457,000
Investments, water department	4,132,000
Bonds authorized but unissued	30,493,000
Market rentals receivable	29,000
Materials and supplies	382,000
Miscellaneous receivables	380,000
Deferred charges to be provided from 1938 funds	116,000
Petty cash	18,000
Prepaid insurance	73,000
Special assessments receivable	1,084,000
Due from State	1,108,000
General taxes receivable	7,742,000
Due from Railways and Electric Co., general	200,000
Water rents receivable	740,000
Total	$465,680,000

Credits

Accounts payable, general	$ 148,000
Accounts payable and accrued interest, water department	27,000
Accrued interest on bonded debt, payable from sinking fund	2,120,000
Accrued interest on paving notes	2,000
Accrued salaries, general employees	114,000
Expendable trust funds balances	12,684,000
Permanent trust funds balances	1,251,000
Funded debt, water department	43,979,000
Funded debt, general	152,226,000
Notes payable, general	1,000,000
Notes payable, water department	86,000
Cash overdrafts, permanent trust funds	12,000
Paving notes, payable from special assessments	610,000
Reserves, miscellaneous purposes	2,000
Reserve for water department deposits	176,000
Reserve for encumbrances, bond fund	1,089,000
Reserve for encumbrances, general	241,000
Surplus, general	9,844,000
Special assessment fund surplus	472,000
Water department surplus	44,697,000

Sinking-fund surplus	$ 23,337,000
Surplus invested in general fixed assets	140,397,000
Unappropriated balance, bond fund	10,212,000
Unencumbered balance of bond fund appropriations	20,954,000
Total	$465,680,000

No. 5 (10 points):

Zed & Company, a co-partnership, was formed on January 1, 1938, with four partners, A, B, C and D. Capital contributions were as follows:

A	$100,000
B	50,000
C	50,000
D	40,000

The partnership agreement provides that each partner shall receive 5% interest on the amount of his capital contribution. In addition A is to receive a salary of $10,000 and B a salary of $6,000 which are to be charged as expenses of the business.

The agreement further provides that C shall receive from the partnership a minimum of $5,000 per annum and D a minimum of $12,000 per annum, both including amounts allowed as interest on capital and their respective shares of profits. The balance of the profits is to be shared in the following proportions:

A	30%
B	30%
C	20%
D	20%

What amount must be earned by the partnership during 1938, before any charge for interest on capital or partners' salaries, in order that A may receive an [illegible] of $25,000 including interest, salary and share of profits? Show calculation in statement form.

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American Institute of Accountants

District of Columbia

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